COMPETITION COMMISSION

Movies on pay TV market investigation

A report on the supply and acquisition of subscription pay-TV movie rights and services

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Website: www.competition-commission.org.uk

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The Competition Commission has excluded from this published version of its final report information which the Inquiry Group considers should be excluded having regard to the three considerations set out in section 244 of the Enterprise Act 2002 (specified information: considerations relevant to disclosure). The omissions are indicated by [✂].

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Summary

The reference

1. On 4 August 2010, Ofcom referred to the Competition Commission (CC) for investigation the supply and acquisition of subscription pay-TV movie rights and the wholesale supply and acquisition of packages which include core premium movies channels (the reference).

2. Ofcom defined ‘subscription pay TV movie rights’ as the intellectual property rights licensed by the six largest Hollywood studios, which:

   (a) permit the exhibition of movies on broadcast channels and/or subscription video on demand (SVOD) services in the UK; and

   (b) relate to the first period during which movies are licensed for exhibition on subscription broadcast channels or SVOD services.

   Ofcom defined ‘core premium movies channels’ as Sky’s movie channels.

3. We were required to determine whether any feature or combination of features of each ‘relevant market’[1] prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the UK or a part of the UK (ie results in an adverse effect on competition (AEC)).

Background

4. The three largest providers of traditional linear (ie scheduled, broadcast) pay TV are Sky, Virgin Media and BT Vision. Sky is the largest provider of pay TV in the UK, with over 10 million subscribers. Virgin Media is by far the largest cable operator in the UK with almost [✂] million subscribers to its pay-TV services. BT Vision, which launched in December 2006, offers linear pay-TV channels via digital terrestrial television (DTT) and on-demand content via Internet protocol TV (IPTV). BT Vision has over [✂] million customers. All three of these traditional pay-TV retailers offer movie services on both a subscription and transactional basis. In addition to pay TV, they also all offer telephony and broadband services.[2]

5. A growing number of other providers offer pay-TV services, in most cases distributing content using the open Internet and, during the course of our inquiry, there were a number of developments in relation to such services which affected our analysis. With regard to movie services, LOVEFiLM (Amazon), Netflix, Apple, YouTube (Google), Microsoft, Blinkbox (Tesco) and KnowHow (Dixons), among others, now offer movies to download or stream on demand. LOVEFiLM and Netflix offer their ‘over the top’ (OTT) services on a subscription basis, while the other Internet-distributed service providers offer movies on a transactional basis.[3]

6. The principal market developments which occurred during the course of our inquiry were: *(a)* the launch by Netflix of a stand-alone OTT SVOD service in the UK;

[1] A ‘relevant market’ is defined in section 134(3) of the Act as a market in the UK for goods or services of a description specified in the reference concerned.
[2] There are two other traditional pay-TV retailers, Top Up TV and TalkTalk TV.
[3] LOVEFiLM offers subscriptions to its OTT SVOD service either on a stand-alone basis or in packages which bundle it with DVD rental by post (and in some cases, games). LOVEFiLM also offers content on a transactional basis. The services of both LOVEFiLM and Netflix offer previously-broadcast television programming as well as movies.

(b) LOVEFiLM's substantial development of its SVOD offering; and *(c)* developments by Sky with respect to its own services, in part in response to these other initiatives. In particular, in July 2012 Sky launched its own stand-alone OTT service (Now TV), which allows consumers to subscribe to Sky Movies without having to subscribe to any other pay-TV content or to a traditional pay-TV platform. We also noted that YouView had announced that its service, enabling consumers to access on their TVs free catch-up video on demand (VOD) services, such as the BBC iPlayer, and paid-for VOD services (as well as linear services by DTT), would be available in 2012.

7. In the UK, as in most geographic markets around the world, movies are sold in different formats in discrete or overlapping release 'windows', through which the studios aim to maximize the value they are able to generate from their movies. Typically, a movie is first released in cinemas, then on DVD, then for transactional video on demand (TVOD), then on subscription pay TV (both linear channels and SVOD) and finally on free-to-air (FTA) TV. After a movie has progressed through these windows, it is categorized as a library movie, at which point it may be exhibited on pay TV and/or FTA TV and/or made available again for TVOD. In most windows, 'hold-back' restrictions limit the extent to which the same movie can be distributed in other formats at the same time (eg a movie in the first subscription pay-TV window (FSPTW) cannot generally be viewed on FTA TV and often cannot be viewed on TVOD). However, certain windows continue to run indefinitely once they have started (eg the DVD window).

8. For the last 20 years, Sky has acquired the exclusive rights to distribute movies from the six largest Hollywood studios ('major studios'), and many other studios, in the FSPTW in the UK, over both its satellite platform and, more recently, the Internet (via Sky Go and Sky Movies on Now TV) as well as on a wholesale basis to Virgin Media (and others). Sky packages this content into 11 linear movie channels and an associated SVOD service.[4] Consumers can subscribe to a pack of channels (ie Sky Movies 1, Sky Movies 2 or dual movies) provided they have also subscribed to a pack of basic channels.[5] Customers may also subscribe to other premium channels (eg Sky Sports 1 or dual sports) to give a combined product (eg dual sports/dual movies), which they take on top of their basic subscription

9. The emergence of the OTT services of LOVEFiLM and Netflix during the course of our inquiry has had a marked impact on the licensing of movies for exhibition on subscription pay TV in the UK. Previously, Sky had licensing agreements with all six major studios and many non-major studios for their FSPTW rights, and BT's Vision Film service and PictureBox (which is available on Virgin Media and as part of Vision Film) had licensing agreements with some major studios and non-major studios for their second subscription pay-TV window (SSPTW) and library rights.[6] Some movies also went directly from the DVD/TVOD windows to FTA TV. However, as a result of the additional interest in licensing movies for exhibition on subscription pay-TV from LOVEFiLM and Netflix, by the end of our inquiry there was considerably more content licensed in an SSPTW, and a third subscription pay-TV window (TSPTW) had emerged. In addition, both LOVEFiLM and Netflix had acquired a substantial amount of non-major studio content in the FSPTW.

[4] A subscriber needs to be a dual movies subscriber (with a high definition (HD) box) to have access to Sky's SVOD service. Dual movies packages include Disney Cinemagic, which shows animated movies including some in the FSPTW.
[5] Except on Now TV where no other pay-TV subscription is required and where Sky Movies is currently the only product available.
[6] Until recently, PictureBox had a very small amount of FSPTW content through its content agreement with Studiocanal.

Theory of harm

10. On the basis of the reference and the initial submissions we received, we articulated the concern to be investigated in our inquiry in terms of a hypothesis, as follows:

> The control by Sky of the acquisition and distribution of movie content on pay TV during the FSPTW, as a result of its market power in the pay-TV retail market, adversely affects competition between pay-TV retailers. This adverse effect on competition in the pay-TV retail market results in effects both on consumers and/or on the suppliers of pay-TV movie rights for the FSPTW (with possible consequential effects on competition between the suppliers of pay-TV movie rights for the FSPTW).

11. We identified four circumstances which we expected to be present were this hypothesis to be correct, which we used to structure our analysis:

(a) Sky has market power as a retailer of pay TV such that there is ineffective competition in the market for pay TV;

(b) pay-TV movie content in the FSPTW is significant to consumers in choosing their pay-TV retailer, which requires, among other things, that movie content on pay TV in the FSPTW has no close substitutes;

(c) other pay-TV retailers (and/or third parties) cannot obtain the rights to sufficient movie content in the FSPTW directly from the studios in order to create movie services which compete effectively with Sky; and

(d) most movie content in the FSPTW on pay TV is controlled by Sky, and there is limited availability to other pay-TV retailers both of movie content in the FSPTW and of Sky's movie products which include this content.

12. In this summary, we provide an outline of our findings on market definition and present our views in each of these four areas, before setting out our overall conclusions.

Market definition

13. Market definition is not an end in itself but rather is a framework within which to analyse the effects of market features. We considered market definition at three levels, namely in relation to the supply of pay-TV products to consumers, the wholesale supply of premium movie channels and the acquisition of movie rights from studios.

14. At the retail level, we started by considering whether the market ought to be limited to Sky Movies, recognizing that it was important to take account of the aggregate constraint on Sky Movies from all substitutes collectively. We found that the frame of reference for our analysis needed to be wider than Sky Movies because consumers' subscription decisions were affected by other elements of pay-TV packages, including at least basic pay-TV content and sports pay-TV content, and competition for subscribers was across all these elements. We included SVOD-only services provided by traditional pay-TV retailers in the pay-TV retail market for similar reasons.

15. We also found that, on the basis that Sky Movies on Now TV offers substantially the same content as Sky Movies on traditional pay TV, and its price is similar to the incremental price of Sky Movies on traditional pay TV (when not bought with Sky Sports), it was highly relevant to our assessment of competition, and we included it in

the retail market. We found that the SVOD OTT services of LOVEFiLM and Netflix were closer competitors to each other than to packages of traditional pay-TV, and that they were not close substitutes for Sky Movies. Nevertheless, we concluded that they would be regarded as substitutable by some consumers and we judged them to be closer substitutes than other pay-TV movie services previously available, such as BT's Vision Film and PictureBox. Overall, we found there to be sufficient rivalry between these OTT pay-TV services and traditional pay-TV services to include them in the retail market

16. It appeared to us that pay-TV retailers imposed a sufficiently strong constraint on each other for pay-TV retailing to be a separate market and we focused our assessment of retail competition on this market. However, we noted that there were links between competition to supply pay-TV products and competition to supply communications products (broadband and telephony) and also that FTA TV exercised some constraint on pay TV. Therefore, we took into account these 'out of market' constraints as appropriate in our assessment of pay-TV retail competition.

17. At the wholesale level, Sky is an actual wholesaler of Sky Movies to Virgin Media and a few small cable pay-TV retailers (and potentially to other retailers) and a notional wholesaler of Sky Movies to itself as a pay-TV retailer. We considered whether it was appropriate to define a market including both the actual and notional wholesale supply of Sky Movies. However, we found that a hypothetical stand-alone wholesaler of Sky Movies would be constrained to some extent by services with content other than major studio FSPTW content and by the possibility of other service providers acquiring FSPTW content from the major studios. Ultimately, we did not see a sustainable source of market power arising simply from wholesaling Sky Movies as such a hypothetical wholesaler would have no direct contact with the customers responsible for the demand for its product. As regards Sky's actual wholesaling of Sky Movies, which was small relative to Sky's notional wholesale supply but in respect of which Sky was an actual monopolist, we found that an assessment of whether this represented a distinct market depended on the validity of the theory of harm we were trying to test.[7] Therefore, we found no appropriate basis for defining a wholesale market consisting of either just the actual wholesale supply by Sky of Sky Movies or the total (actual and notional) wholesale supply of Sky Movies. However, this approach did not limit the scope of our analysis of competition relevant to the wholesale supply and acquisition of packages including Sky Movies channels as set out in our terms of reference (see paragraphs 41 and 42).

18. At the rights level, we found that the appropriate frame of reference for considering issues in relation to the supply and acquisition of FSPTW movie rights was a price-discrimination market limited to FSPTW movie rights, but including the FSPTW movie rights of all studios. However, this did not preclude us from considering a broader range of movie rights where this was necessary for our analysis of competitive effects.

Retail competition

19. Pay-TV retailers compete for subscribers, but we found that this competition was affected by barriers to consumers switching their pay-TV retailer, particularly with

[7] If our theory of harm, including circumstance *(d)* (referred to in paragraph 11*(d)*) was valid, then it would follow that Sky's wholesale prices for Sky Movies would be above the competitive level; while if our theory of harm was not valid, then we would not be able to say that Sky's wholesale prices for Sky Movies were above the competitive level and we would not be able to define a wholesale market. Accordingly, we did not think that adopting for the purposes of our inquiry a market definition limited to Sky's actual wholesale supply of Sky Movies could lead to an appropriate framework for assessing our theory of harm as this would be close to assuming what we were setting out to test.

respect to switching between traditional pay-TV retailers. We found that these barriers were associated with the perceived inconvenience of changing retailer and with subscriber inertia. In addition, we found that there were significant barriers to large-scale entry and expansion for a traditional pay-TV retailer offering packages of pay TV, including substantial sunk costs both in setting up a new platform and in marketing to acquire subscribers (associated with the need to overcome the barriers to switching, in particular subscriber inertia), and the threat of a competitive response from existing players. Together with Sky's large number of existing subscribers deriving from its historical position (Sky's incumbency advantage) and the restricted geographical coverage of Sky's main historical competitor (Virgin Media), it appeared to us that these factors resulted in Sky having market power in the pay-TV retail market. The emergence of the OTT services of LOVEFiLM and Netflix, which offered movies and previously-broadcast TV programming on demand, had increased the extent of competition in the pay-TV retail market but not sufficiently to affect our conclusion that Sky had market power.

20. Overall, we found that there was some competition in the pay-TV retail market but the very high and stable level of concentration, the low level of switching between suppliers, the difficulty of large-scale entry/expansion as a traditional pay-TV retailer and the absence of countervailing buyer power in pay TV indicated that, at the time of our report, competition was not effective. We noted that Sky's high profitability from its pay-TV activities was consistent with this finding.

21. We found that Ofcom's concern that Sky's market power in pay TV might prevent the emergence of competition in SVOD services did not appear to have been realized as new SVOD services offering a broad range of movie (and other) content had entered the market and captured a sizeable subscriber base in a short period of time. Based on the evidence available to us at the time of reaching our findings, we expected competition in relation to SVOD services to be sustained and, consequently, we expected OTT services increasingly to constrain traditional pay-TV retailers over time. Nevertheless, we could not exclude the possibility that circumstances might subsequently arise such as to limit the development of OTT services in competition with Sky in the future and, in this regard and in the light of our judgment that Sky has market power, we considered that the conditions of competition should be kept under close review (see paragraph 53).

22. Notwithstanding our finding that competition in the pay-TV retail market was not effective, the reference made to us required us to consider in particular the extent to which there were features associated with the distribution of Sky Movies and the acquisition of FSPTW rights from the major studios which adversely affected competition. A conclusion that competition was not effective in this market did not of itself lead to the conclusion that there was an AEC with respect to the matters referred to us. Nevertheless, this finding provided the context for our subsequent analysis.

Significance of FSPTW movie content

23. In light of our finding that Sky has market power in the pay-TV retail market overall, the question as to the role of FSPTW content (and Sky Movies which has the majority of this content) in consumers' choice of traditional pay-TV retailer was a key issue for our inquiry.[8]

[8] Our concern was with the significance of *Sky's* FSPTW movie content to consumers' choice of *traditional* pay-TV retailer because Sky had the majority of FSPTW content and the ineffectiveness of competition in the pay-TV retail market derived from Sky's position in traditional pay-TV retailing.

24. We noted that the number of viewings of Sky Movies had been falling over recent years and by the time of our report, Sky Movies accounted for only a little more than 1 per cent of all TV viewing and 2 per cent of viewing hours in pay-TV homes. In response to our survey in December 2010 (prior to the launch of the OTT services of LOVEFiLM, Netflix and Now TV), around two-thirds of respondents who subscribed to pay TV said that they first subscribed in order to access a greater choice (range) of TV programming compared with that on FTA channels, and relatively few said that they had first subscribed in order to watch a wider range of films.

25. The results of this survey also suggested that only around 10 per cent of all pay-TV subscribers would stop paying for their current pay-TV subscription if their provider stopped offering Sky Movies. We recognized that, for various reasons, the results of this survey may have slightly under- or overstated the relevant proportion and we did not attach any great importance to the precise figure of 10 per cent,[9] but we believed that this indicated that the availability of Sky Movies was significant to the traditional pay-TV subscription decisions of only a relatively small minority of all traditional pay-TV subscribers. Other survey evidence supported this conclusion. In particular, our December 2010 survey suggested that only around 6 per cent of all traditional pay-TV subscribers regarded Sky Movies as very important in their decision to have a traditional pay-TV service, and 11 per cent considered it quite important. Also, for example, survey evidence from Ofcom suggested that the availability of Sky Movies was important to fewer consumers than the availability of other pay-TV channels, in particular Sky Sports.

26. We also considered Sky's marketing budget and found that the amount attributable to Sky Movies was consistent with Sky Movies being of limited significance in attracting subscribers to its pay-TV platform.

27. Overall, this evidence suggested that the availability of Sky Movies was significant to the pay-TV subscription decisions of only a relatively small minority of pay-TV subscribers. However, the central issue that we had to address was the significance of FSPTW content. Therefore, we considered evidence on the attributes of movie services which were valued by Sky Movies subscribers. This was informative as to the extent to which current subscribers valued Sky Movies because of its FSPTW content as opposed to its other features. More generally, this evidence facilitated our assessment of the extent to which consumers valued different movie service attributes, and therefore the extent to which pay-TV subscribers were likely to regard other movie services as being substitutable for Sky Movies.

28. Our December 2010 survey found that 12 per cent of Sky Movies subscribers regarded the 'length of time you have to wait after a film is shown at the cinema before you can watch it on TV' (ie recency) as a very important attribute of a pay-TV movie service. However, this attribute was very important to considerably fewer consumers than several other attributes, including the overall cost of the service (which was the most important factor), the availability of movies on demand, the availability of the service on a subscription basis and the minimum length of contract. In addition, the total number of films available to watch (ie range) was considered to be very important by 26 per cent of consumers, ie more than double the proportion who thought that recency was very important. An analysis of the proportion of Sky Movies subscribers who considered different movie service attributes to be 'quite important' provided similar results. Survey evidence from Ofcom and Sky was also consistent.

[9] In other words, our conclusions would not be any different if the true figure were a few percentage points higher or lower.

29. Overall, the evidence suggested that the availability of Sky Movies was significant to only a relatively small minority of pay-TV subscribers in their choice of traditional pay-TV retailer and, further, that many consumers within this sub-group placed more weight on other factors than on Sky Movies' FSPTW movie content (ie they valued other attributes of Sky Movies more).

30. Almost all of the survey evidence which led us to these views was gathered prior to the launch of the OTT services of LOVEFiLM, Netflix and Now TV in December 2011, January 2012 and July 2012 respectively. Although not close substitutes for Sky Movies obtained through a traditional pay-TV retailer, the OTT services of LOVEFiLM and Netflix provide consumers with alternative pay-TV movie services and, in our view, at least some of those for whom Sky Movies would otherwise be significant in their traditional pay-TV subscription decisions were likely to regard these services as substitutable for Sky Movies. We formed this view in the light of the different attributes of the products available and on the basis of the movie service attributes valued by Sky Movies subscribers (see above). In particular, we noted that while Sky Movies had considerably more FSPTW content, the rival OTT services of LOVEFiLM and Netflix offered a larger number of movies (as well as some FSPTW content), were significantly cheaper and did not require a minimum contract period.

31. Nevertheless, we recognized that there would be some within the small minority of pay-TV consumers for whom Sky Movies was significant to their choice of traditional pay-TV retailer who would not regard the OTT services of LOVEFiLM and/or Netflix as substitutable for Sky Movies. In respect of this group of consumers, which in our view was likely to be very small relative to all pay-TV subscribers, we noted that the launch of Now TV meant that they could now obtain Sky Movies, distributed over the open Internet, without the need to subscribe to any basic paid-for content and separately from a subscription to pay-TV services on a traditional pay-TV platform (whether Sky's platform or one of its rivals). As such, these customers had the option of subscribing to Sky Movies independent of their traditional pay-TV subscription decision. Again, we recognized that not all consumers within this group would regard Sky Movies on Now TV as an effective substitute for Sky Movies on a traditional pay-TV platform (where it can be bundled with other content) but, in our view, it was likely that some would. We noted, in particular, that the content on Sky Movies on Now TV was very similar to the content within Sky Movies packages available through Sky's DTH platform or through Virgin Media, and the price was also similar (in fact marginally less than the incremental price of Sky Movies on Sky's DTH platform for customers who did not subscribe to Sky Sports).

32. In our view, Sky's decision to make Sky Movies available on Now TV, unbundled from other content, was consistent with the significance of Sky Movies to consumers in their choice of traditional pay-TV retailer having fallen. We also noted that, through the course of our inquiry, Sky had reduced its wholesale prices for certain of its products which incorporate Sky Movies, and had reached agreement with TalkTalk to supply Sky Movies on a wholesale basis. It appeared to us that these further developments were also consistent with this view (see paragraph 42), though we put less weight on them.

33. Overall, taking into account all the evidence and findings set out above, including that only a very small minority of all pay-TV subscribers were likely to regard the availability of FSPTW content as significant in choosing (or deciding whether to stay with) a traditional pay-TV retailer, and given the developments in the market which occurred through the course of our inquiry, we concluded that FSPTW content was

not significant to consumers in their choice of traditional pay-TV retailer for the purposes of this part of our theory of harm.[10]

Barriers to the acquisition of FSPTW movie rights

34. As part of our assessment of significance, we considered the extent to which the OTT services of Netflix and LOVEFiLM were substitutes for Sky Movies and we took into account the content rights which each of these OTT pay-TV retailers had acquired at the time of our report. In reaching our finding on significance, we did not rely on any expectation that either Netflix or LOVEFiLM (or any similar service that might become available in the longer term) would offer a superior content proposition (in terms of range or recency) than either did at present.

35. We observed that, between them, Netflix and LOVEFiLM had already signed exclusive FSPTW agreements with most of the large non-major studios, which suggested that there were no material barriers to the acquisition of FSPTW content from this group of studios. We also observed that Netflix and LOVEFiLM had acquired a significant amount of content in other windows from both major and non-major studios, which suggested that there were no significant barriers to OTT distributors acquiring content in other windows, and indeed we received no evidence in the course of our inquiry to suggest otherwise. Overall, there appeared to be no barriers to acquiring content such as to prevent LOVEFILM and/or Netflix from maintaining their OTT offering (or an equivalent provider developing a similar proposition), which we had found to be a substitute for some subscribers to Sky Movies (see Section 6).

36. Accordingly, it appeared to us that any further assessment of barriers to the acquisition of movie content rights was not required in order to enable us to conclude that our theory of harm was not satisfied. However, as part of our inquiry into the market which was referred to us, we have throughout considered a number of issues relating to the extent to which there are barriers to acquiring movie content in the FSPTW and we considered it appropriate to report our analysis and findings on some of these issues notwithstanding our finding on significance.

37. Over the last 20 years, Sky has been the only party which has acquired the FSPTW rights of any major studio in the UK. In our view, traditional pay-TV rivals, or content aggregators seeking to supply traditional pay-TV rivals, have historically faced material barriers to acquiring the FSPTW rights of the major studios because Sky's position, with a substantial incumbent base of Sky Movies customers, has meant that, when bidding for rights, Sky has been more confident relative to its rivals that it will be able to monetize the rights it acquires. This has enabled Sky to bid more for the rights than its rivals.

38. In our view, traditional pay-TV rivals in the past could not rely on being able to circumvent these disadvantages, either by retailing directly to consumers via Sky's DTH satellite platform (due to marketing costs and the disadvantages it would face relative to Sky in being unable to bundle its channel with Sky's other channels and services) or by wholesaling to Sky (due principally to the risks associated with entering into a commercially attractive wholesale arrangement with Sky).

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[10] We reached this finding recognizing that there would still be some subscribers who were likely to continue to regard the FSPTW content on Sky Movies as significant to their pay-TV subscription decisions. However, in any market, there may be some consumers who are wedded to a particular product, but that does not mean that the market (or even a material part of it) is uncompetitive as a result. Further, as is inevitable in a case like this, the issue of where to draw the line is ultimately a matter of judgement, which we have exercised in the light of all the evidence.

39. However, we found that the barriers faced by OTT pay-TV retailers in acquiring FSPTW content were lower than for traditional pay-TV retailers principally because we found that OTT pay-TV retailers, such as LOVEFiLM or Netflix, were likely to face fewer difficulties than a traditional pay-TV retailer in attracting subscribers to their movie services. This was because they could generate new consumption from the large pool of potential customers who were not currently pay-TV subscribers and also because the barriers to traditional pay-TV subscribers taking up OTT services (as an addition to or partial replacement for a traditional pay-TV package) were likely to be lower than the barriers to switching traditional pay-TV retailer. We noted that, in the future, as the customer bases of these providers increased, their ability to monetize the value of the rights they obtained would improve and they would incur less risk when bidding, eroding Sky's bidding advantage further.

40. We observed that both LOVEFiLM and Netflix had each acquired FSPTW content from non-major studios, [✂]. We also observed that, [✂]. While we could not be certain of the commercial incentives of any party to participate in any given auction process and ultimately to make the necessary investment to win, in our view, there was a realistic prospect that, in the future, an OTT pay-TV retailer would be able to outbid Sky for the FSPTW rights of at least one major studio.

Availability of FSPTW movie content and products to other pay-TV retailers

41. Our findings on the significance of FSPTW content to consumers in their choice of traditional pay-TV retailer implied that it was implausible that the terms of Sky's wholesale supply of Sky Movies could cause Sky's rivals to be at such a disadvantage when competing for pay-TV subscribers as to harm competition. Therefore we did not believe it was necessary for us to examine issues in relation to wholesale supply by reference to the questions we posed under part *(d)* of our theory of harm in order to reach a conclusion overall as to whether our theory of harm was made out. Nevertheless, we acknowledged that, if there was clear evidence indicating that Sky was seeking to restrict the supply of Sky Movies, in order to constrain its rivals' ability to compete with Sky for pay-TV subscribers, this might cast some doubt on the views we had reached on the significance of FSPTW content based on other evidence.

42. We found that, in relation to price, it was not clear that rivals were at the time of our report at a material disadvantage when retailing Sky Movies; and, in relation to non-price terms, the relevant evidence was inconclusive as to whether rivals were, or ever had been, at a material disadvantage when retailing Sky Movies. However, importantly, we found that the evidence on Sky's conduct in terms of its wholesale supply was not such as to cast doubt on our views on the significance of FSPTW content which we had reached on the basis of other evidence. We also noted that changes in Sky's wholesale behaviour, both in reducing its wholesale prices for certain of its products which incorporate Sky Movies and in reaching a wholesale agreement with TalkTalk, were consistent with the significance of FSPTW content to consumers in their choice of traditional pay-TV retailer having fallen (see paragraph 32).

43. We recognized that the recent statements and actions of parties might have been influenced by our inquiry and that there were many uncertainties in relation to the future negotiations for the wholesale supply of Sky Movies. We also recognized that if there was a material change of circumstance with respect to Sky's wholesale supply of Sky Movies, this might warrant scrutiny by Ofcom (see paragraph 53).

Effects of Sky's position with respect to the acquisition and distribution of FSPTW movie content on competition between the suppliers of pay-TV movie rights

44. In the upstream market (the market in which FSPTW movie rights are supplied and acquired (see paragraph 18)), there are many studios which license the rights to distribute their content and no studio has a particularly large or stable market share. Overall, we found that there was no reason to investigate a distinct theory of harm relating to ineffective competition between the suppliers of movie rights at the up-stream level.

45. Nevertheless, the demand side of the upstream market, in which aggregators of movie content (ie broadcasters or other service providers) bid for movie rights in the FSPTW, is concentrated, with Sky having obtained for many years a licence to these rights from all of the major studios (and many other non-major studios). Therefore, we considered whether Sky's position as an acquirer and distributor of FSPTW movie content on pay TV might adversely affect competition between the suppliers of FSPTW movie rights.

46. In our view, the evidence did not clearly indicate that the major studios had historically achieved either prices or terms in the UK which were worse compared with other territories where there was more than one licensee of their FSPTW rights. Furthermore, although there was some evidence to suggest that, [✄]. We also found no reason to believe that any restriction on the ability of some non-major studios to compete would necessarily have adversely impacted upon final consumers given that competition between the major studios appeared to us to be broadly effective. Moreover, we noted that, more recently, there had been greater competition for FSPTW rights.

47. Therefore, we found that Sky's position as an acquirer and distributor of FSPTW movie content did not give rise to an AEC in the upstream rights market.

Market developments

48. In its Pay TV Statement, Ofcom acknowledged that its investigation came at a time of 'disruptive change' in the way in which content was distributed. While pay-TV services had historically been delivered primarily via satellite and cable networks, DTT offered the scope for pay-TV to be delivered via aerials, and new broadband networks offered consumers an unprecedented choice of content, and the ability to access that content on demand. However, Ofcom stated that the ability to provide such services depended on access to content which consumers wanted to watch and it had a number of concerns, including that the emergence of SVOD movie services might be inhibited by the fact that Sky had exclusive broadcast rights to all the Hollywood movies of the major studios in the FSPTW.

49. At the time of our August 2011 provisional findings, we considered whether demand for Internet-distributed movie services (VOD and EST) might grow so as to alter materially the competitive conditions relating to the supply of products with FSPTW movie content. However, at that time, there were no stand-alone SVOD services available with FSPTW content,[11] and the range and quality of the movies offered on the subscription services available at that time was limited compared with the content

[11] At that time, LOVEFiLM offered bundled packages of DVD rental by post and a streaming service. Also, BT Vision offered Film Club and both Virgin Media and TUTV offered PictureBox but, in almost all cases, these products were sold bundled with basic pay TV. None of these services had much (if any) FSPTW content.

offered by Sky Movies. Furthermore, these services had few subscribers compared with Sky Movies. At that time, demand for both TVOD and EST services was also very small relative to the demand for Sky Movies.

50. While we recognized in our August 2011 provisional findings that the way in which some people watched movies was changing and that there were many developments which might occur and which might affect the extent of competition in the market, the evidence before us at that time was insufficient for us to reach the view that changes were likely in the foreseeable future such as would affect our AEC assessment. However, we retained an open mind and continued to consider relevant market developments throughout the course of our investigation, as well as taking account of responses to our consultations. In the light of the material changes we observed and representations received, our views changed.

51. Specifically, in relation to the significance of Sky Movies and FSPTW content, our views changed in part because of the emergence of the new OTT services of LOVEFiLM, Netflix and Now TV, which affected the competitive landscape by increasing the choices available to consumers. We also reconsidered and revised our original analysis both in light of points raised in response to our August 2011 provisional findings and in light of the developments taking place in the market with which that analysis appeared to be inconsistent. Market developments also led us to believe that Sky's advantages when bidding for FSPTW rights were less than we had initially thought and were likely to erode further, particularly for OTT pay-TV retailers. We published revised provisional findings setting out our revised views in May 2012 and we have taken account of responses to our revised provisional findings in reaching our final views.

52. At the time of reaching our findings there was necessarily limited empirical evidence on the implications of some of the recent developments which we took into account.[12] Overall, our findings were based largely on current market circumstances but, where necessary, we formed expectations as to whether relevant circumstances were likely to persist. In particular, as the launch of new OTT services was relevant to our analysis, we could not ignore or attribute no weight to them simply because we had less evidence relating to them than in respect of the (now changed) circumstances before they were launched. Therefore, we exercised our judgement and formed a view as to their likely implications in the light of the evidence available. In doing so, we recognized that it was not possible to reach precise conclusions as to how developments would ultimately turn out in the future, and we exercised caution accordingly. To the extent that they were relevant to our conclusions, we sought to rely only on broader conclusions which we believed were clearly justified by the evidence available. For example, our findings did not rest on any precise prediction as to the likely subscriber numbers of LOVEFiLM and Netflix in, say, two years, but they did rest in part on a much broader expectation that at least one OTT movie service (whether LOVEFiLM or Netflix or an equivalent service) would survive in the market in competition with Sky Movies in the longer term.

53. We also put weight on the expectation that Sky was likely to continue to offer Sky Movies on Now TV (or an equivalent service) on an unbundled basis, enabling consumers to subscribe to Sky Movies separately from any other pay-TV content and separately from a subscription to pay-TV services via a traditional pay-TV platform

[12] In respect of the OTT services of LOVEFiLM and Netflix, we commissioned a survey in February 2012 which provided us with some relevant data, but we acknowledged a number of issues concerning the interpretation of the data, including that the responses of early subscribers might not be representative of future subscribers so, with those caveats in mind, we did not rely on the results of that survey in isolation. The launch of Sky Movies on Now TV occurred too recently for us to commission any survey evidence on its early performance. A substantial part of our analysis was based on considerations other than those relating to the recent market developments.

(whether Sky's platform or one of its rivals). Further, given our finding on significance, we did not expect Sky to have a strategic incentive to withhold or limit the availability of Sky Movies in order to provide it with an advantage over its rivals in competing for subscribers in the pay-TV retail market (see paragraph 41).[13] However, in light of Sky's position in the pay-TV retail market and also recognizing the fast-moving nature of the market, we expected Ofcom to keep developments in this sector under review and we noted that, in the event that circumstances changed materially, some renewed scrutiny of the issues covered by our inquiry might be warranted.

Findings

54. Ofcom referred us two markets (see paragraph 1) and we were required to consider and decide the statutory question (see paragraph 3) in respect of each of these markets.

55. While we continued to take the view that Sky had market power in the pay-TV retail market, the focus of the reference made to us was the provision of movie services and, in particular, the distribution of movie services with FSPTW content from the major studios and the acquisition of these movie rights. Taking all the relevant evidence into account, we concluded that the FSPTW content on Sky Movies was not significant to consumers' choice of traditional pay-TV retailer (see paragraphs 23 to 33). This meant, in our view, that Sky's position with regard to the acquisition and distribution of FSPTW movie content on pay TV did not give it such an advantage over its rivals as to adversely affect competition in the pay-TV retail market.

56. While not necessary in order for us to reach a view on the statutory questions, we noted that, as regards barriers to the acquisition of FSPTW movie rights, the barriers faced by OTT pay-TV retailers in acquiring FSPTW content were lower than those for traditional pay-TV retailers. In our view, there was a realistic prospect that, in the future, an OTT pay-TV retailer would be able to outbid Sky for the FSPTW rights of at least one major studio (see paragraphs 34 to 40). We regarded this as supportive of our overall finding.

57. We also found that Sky's position as an acquirer and distributor of FSPTW movie content did not give rise to an AEC in the upstream rights market.

58. Therefore, we found that there were no features relating to 'the supply and acquisition of subscription pay-TV movie rights in the FSPTW of the major studios' or 'the wholesale supply and acquisition of packages including core premium movies channels' which gave rise to an AEC in any market.

[13] Clear evidence to the contrary might cast some doubt on the views we had reached on the significance of FSPTW content based on other evidence (see paragraph 41).

Findings

1. The reference

1.1 On 4 August 2010, Ofcom referred to the CC for investigation the supply and acquisition of subscription pay-TV movie rights and the wholesale supply and acquisition of packages which include core premium movies channels (the reference).[1]

1.2 Ofcom defined 'subscription pay TV movie rights' as the intellectual property rights licensed by the six largest Hollywood studios, which:

(a) permit the exhibition of movies on broadcast channels and/or SVOD services in the UK; and

(b) relate to the first period during which movies are licensed for exhibition on subscription broadcast channels or SVOD services.

Ofcom defined 'core premium movies channels' as Sky's movie channels.

1.3 We were required to determine whether any feature or combination of features of each relevant market in which the reference products are supplied or acquired prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the UK or a part of the UK (ie results in an AEC).[2]

1.4 The full text of the reference is set out in Appendix 1.1.

Background to the reference

1.5 The process leading to the reference began in January 2007 when BT, Setanta, Top Up TV (TUTV) and Virgin Media asked Ofcom to refer the pay-TV industry to the CC for investigation on the basis that competition was not working properly. Ofcom announced that it was opening an investigation into the pay-TV industry in March 2007, and published three consultation documents between December 2007 and June 2009 in which Ofcom considered in particular issues relating to both premium movie and premium sports content.[3,4,5]

1.6 Ofcom concluded its investigation in March 2010 when it published its Pay TV Statement.[6]

1.7 Ofcom noted that the pay-TV sector had delivered substantial benefits to consumers since its emergence in the early 1990s, with customers now having access to a greater choice of content, at higher quality, than had historically been available from FTA broadcasters. Ofcom stated that Sky had been at the forefront of this development and had delivered substantial benefits to millions of consumers in the UK.

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[1] The reference was made under sections 131 and 133 of the Act.
[2] See section 134(1) of the Act.
[3] December 2007, First Pay TV Consultation:
http://stakeholders.ofcom.org.uk/binaries/consultations/market_invest_paytv/summary/pay_tv.pdf.
[4] September 2008, Second Pay TV Consultation:
http://stakeholders.ofcom.org.uk/binaries/consultations/second_paytv/summary/condoc.pdf.
[5] June 2009, Third Pay TV Consultation:
http://stakeholders.ofcom.org.uk/binaries/consultations/third_paytv/summary/paytv_condoc.pdf.
[6] http://stakeholders.ofcom.org.uk/binaries/consultations/third_paytv/statement/paytv_statement.pdf.

1.8 Ofcom acknowledged that its investigation came at a time of 'disruptive change' in the way in which content was distributed. While pay-TV services had historically been delivered primarily via satellite and cable networks, DTT offered the scope for pay-TV to be delivered via aerials, and new broadband networks could offer consumers an unprecedented choice of content, and the ability to access that content on demand.

1.9 However, Ofcom also stated that the ability to provide such services depended on access to content which consumers wanted to watch, and for many years Sky had held the exclusive broadcast rights to both much of the most sought-after premium sports content and almost all Hollywood movies in the FSPTW. Ofcom's approach, though, varied as between sports and movie content, as explained below.

1.10 In respect of sports content, Ofcom decided to require Sky to offer its Sky Sports 1 and Sky Sports 2 packages to other pay-TV retailers at prices set by Ofcom using its powers under the Communications Act 2003 (CA 2003).[7] This was known as a 'wholesale must-offer' (WMO) remedy. In June 2010, Sky appealed this decision to the Competition Appeal Tribunal (CAT).[8] A number of interested parties intervened in the Sky appeal and BT, Virgin Media and the Football Association Premier League (FAPL) separately appealed aspects of Ofcom's Pay TV Statement. At the time of publishing this report, judgments in respect of all of these appeals were still awaited.

1.11 In respect of movies, Ofcom found that Sky controlled the rights required for services showing movies in the FSPTW on both linear channels and SVOD services. However, Ofcom stated that the position was complex as consumers could purchase movies content in a variety of ways, and the importance of linear channels was starting to reduce. Ofcom expected video-on-demand (VOD) services to become increasingly important to consumers and it was concerned that Sky's position could limit competition in these services in the future. Ofcom felt that it could not adequately address this concern under its Communications Act powers, which related primarily to linear channels, and therefore concluded that it should make a market investigation reference to the CC.

1.12 As a result, at the same time as publishing its Pay TV Statement, Ofcom also published a consultation document, setting out its proposals to make a market investigation reference to us with regard to movies on pay TV.[9] On 4 August 2010, following this consultation process, Ofcom published its decision to make a market investigation reference to the CC.[10]

1.13 A more detailed summary of Ofcom's investigation and reasoning is set out in Appendix 1.1.

Conduct of our investigation

1.14 In conducting our investigation we had regard to the CC's published guidelines on market investigations[11] and other published guidance, and throughout our investigation we were concerned to ensure that our processes were both thorough and fair.

[7] Ofcom also, in principle, approved Sky and Arqiva's request for Sky to offer its own pay-TV services on DTT ('Picnic'). This approval was conditional on a WMO obligation on Sky Sports 1 and 2 being in place and was conditional on any movies channels included in Picnic being offered to other DTT retailers. Ultimately, Sky/Arqiva did not pursue the Picnic proposal and, to date, Sky has not introduced a pay-TV service on DTT.
[8] *British Sky Broadcasting Limited v Office of Communications (Case No 1158/8/3/10):* www.catribunal.org.uk/237-6549/1158-8-3-10-British-Sky-Broadcasting-Limited.html.
[9] http://stakeholders.ofcom.org.uk/binaries/consultations/movies_reference/summary/moviescondoc.pdf.
[10] http://stakeholders.ofcom.org.uk/binaries/consultations/movies_reference/statement/pay-tv-movies-decision.pdf.
[11] *Market Investigation References: Competition Guidelines*, *CC3*, June 2003.

Details of the steps undertaken in the course of our investigation are set out in Appendix 1.1.

1.15 Overall, we received written and oral evidence from over 30 companies, organizations and individuals and many parties provided assistance by responding to our questionnaires. These submissions have informed our assessment at each stage of our process.

1.16 This report takes account of all the evidence we received during the course of our investigation, including parties' comments and arguments put to us in response to our working papers, our provisional findings in August 2011, the Notices of possible remedies in August and November 2011, and our revised provisional findings in May 2012.

1.17 We are required under the Act to have regard to the need to exclude from disclosure information whose disclosure could significantly harm legitimate commercial or individual interests or whose disclosure we consider would be contrary to the public interest. Subject to that proviso, we have sought throughout our investigation, and in preparing this report, to be as transparent as possible with respect to the material we have published and received.

Structure of this report

1.18 This document, together with its appendices, constitutes our report on the statutory questions that we have to decide under section 134 of the Act. It refers, where appropriate, to material not forming part of the document but published separately on the CC website and parties studying the report may want from time to time to refer to this material. The report, however, is self-contained and is designed to provide all material necessary for the understanding of our findings and decisions.

1.19 The rest of this document is structured as follows:

(a) in Section 2 we provide background information in relation to the pay-TV industry and the licensing of movie rights and describe the movie services available on pay TV;

(b) in Section 3 we set out the theory of harm which we used to structure our analysis;

(c) in Section 4 we address market definition, considering first the retail level, then the wholesale level, and then the rights level;

(d) in Section 5 we examine whether there is effective competition in the pay-TV retail market and whether Sky has market power in that market;

(e) in Section 6 we consider the significance of FSPTW content to consumers' choice of pay-TV retailer;

(f) in Section 7 we discuss barriers to the acquisition of FSPTW content, in particular from the major studios;

(g) in Section 8 we consider the terms on which Sky supplies Sky Movies on a wholesale basis;

(h) in Section 9 we address the question of whether Sky's position with respect to the acquisition and distribution of FSPTW movie content on pay TV might adversely affect the suppliers of FSPTW movie rights and competition between them; and

(i) in Section 10 we present and summarize our overall findings, answering the statutory question as to whether there are features relating to the supply and acquisition of subscription pay-TV movie rights of the major studios in the FSPTW or the wholesale supply and acquisition of packages which include core premium movies channels which give rise to an AEC in any market.

2. Background

2.1 In this section, we provide an overview of the UK TV industry, focusing on pay TV. We briefly describe the pay-TV supply chain and the principal retailers of subscription pay-TV services, both on a traditional basis and via the Internet. We then describe the provision of movie content by the content rights holders, and provide an outline of the 'windowing' structure. Finally, we consider how movie services are provided and consumed in the UK and the implications of technological advances which are changing how movies are watched and the choices available to consumers when choosing pay-TV providers.

TV industry overview

2.2 Watching TV is a popular activity. In 2011, UK consumers watched on average over 4 hours a day.[1] They did so on a total of 60 million TV sets, of which approximately 25 million are 'main' sets (the most-watched set in each TV household), and the remainder are 'secondary' sets (in bedrooms, kitchens, etc). In addition, TV content is viewed on computers and portable devices such as mobile phones or tablets.

2.3 TV content may be viewed in 'linear' mode, ie at the time and in the sequence it is broadcast,[2] or it may be viewed in non-linear mode, either time-shifted through the use of a recording device such as a personal video recorder (PVR),[3] or through VOD whereby the consumer selects the content to be viewed and chooses when to watch it. VOD viewing has grown in part due to the availability of free, catch-up services provided by the FTA broadcasters, eg the BBC iPlayer.[4] In 2010, VOD accounted for only around 5 per cent of TV viewing overall,[5] but it has been growing rapidly as a mode of TV consumption. In 2011, almost 2 billion programmes were viewed on the BBC iPlayer, with viewings in December 2011 on connected TVs being more than 1,000 per cent greater than in December 2010 and viewings on mobile phones and tablets increasing year on year by 163 and 596 per cent respectively (though most viewings continue to be on computers).[6]

2.4 TV content may be provided by 'public service broadcasters' (PSBs),[7] whose status carries certain rights and obligations, or by non-PSB broadcasters. In 2011, viewing of the five main PSB channels accounted for 54 per cent of hours viewed.[8]

2.5 TV services may be made available to consumers for free, and publicly funded in the case of the BBC, or advertising funded in the case of channels provided by commercial operators, eg ITV; or, alternatively, services may be paid for, either via a subscription or on a transactional basis.

2.6 There are two analogue distribution technologies, both of which are being phased out: analogue terrestrial TV and analogue cable TV. However, after digital switch-over, which is scheduled for completion in the autumn of 2012, all consumers of TV in the UK will access content using digital technology.

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[1] www.barb.co.uk/facts/tv-trends?_s=3.
[2] Time-shifted channels (eg ITV3+1) fall within the definition of linear channels.
[3] Also called a digital video recorder (DVR).
[4] As from February 2011, iPlayer could be used to find content from ITV, Channel 4, Five and SeeSaw, though this content could also be accessed directly through, for example, the 4oD website.
[5] www.slideshare.net/ipietro/uk-video-ondemandforecasts-to-2015.
[6] www.chicagotribune.com/entertainment/sns-201201161659reedbusivarietynvr1118048689jan16,0,5319731.story.
[7] BBC, ITV1 (including GMTV1), Channel 4, Five and S4C.
[8] http://stakeholders.ofcom.org.uk/binaries/research/cmr/cmr12/CMR_UK_2012.pdf, p9.

2.7 There are four digital distribution technologies: *(a)* DTT; *(b)* digital satellite (DSat) (otherwise known as 'direct to home' (DTH)); *(c)* digital cable; and *(d)* the Internet (either IPTV, using a closed or proprietary Internet connection, or OTT using the open Internet). In addition, there are 'hybrid' services which employ two or more technologies together: for example, BT Vision is a hybrid DTT/IPTV service, with broadcast services being received via DTT through a TV aerial while VOD and interactive services are delivered via a broadband Internet connection.[9]

FTA digital TV

2.8 In October 2002, Freeview launched as an FTA DTT service, following the closure of ITV Digital. Following digital switchover, this will be the standard way in which free terrestrial TV is accessed.[10] The original Freeview consortium included the BBC, Sky and Crown Castle (now Arqiva), with ITV and Channel 4 joining subsequently in 2005. When we published our provisional findings in August 2011, around three-quarters of UK homes had Freeview on at least one TV, with over 9 million homes using it as their primary source of TV (about the same number as use Sky and twice as many as Virgin Media (see Table 4.1 in Section 4)).

2.9 Freeview enables consumers to access a wider range of channels than is available via analogue reception, without a monthly subscription, and using an existing rooftop antenna combined with a DTT tuner, which may be built in to a TV or sold separately. Freeview offers about 50 TV channels, including four in HD, and 24 radio stations.[11]

2.10 Freesat is a 50:50 joint venture between the BBC and ITV which launched FTA digital satellite services in May 2008. It offers a range of standard definition (SD) and HD channels and Freesat told us that it might introduce paid-for services in the future. Over 2 million Freesat boxes and TVs have been sold since its launch.[12]

2.11 YouView is a new service which 'soft-launched' in July 2012.[13] YouView is a joint venture in which the main FTA broadcasters (BBC, ITV, Channel 4 and Channel Five), two existing pay-TV retailers (BT and TalkTalk) and Arqiva (which transmits DTT services) have equal shareholdings. YouView told us that it aimed to help create and promote common technical specifications to enable the provision of linear TV through DTT combined with on-demand services via the Internet direct to the TV (or via the set-top box (STB)).[14]

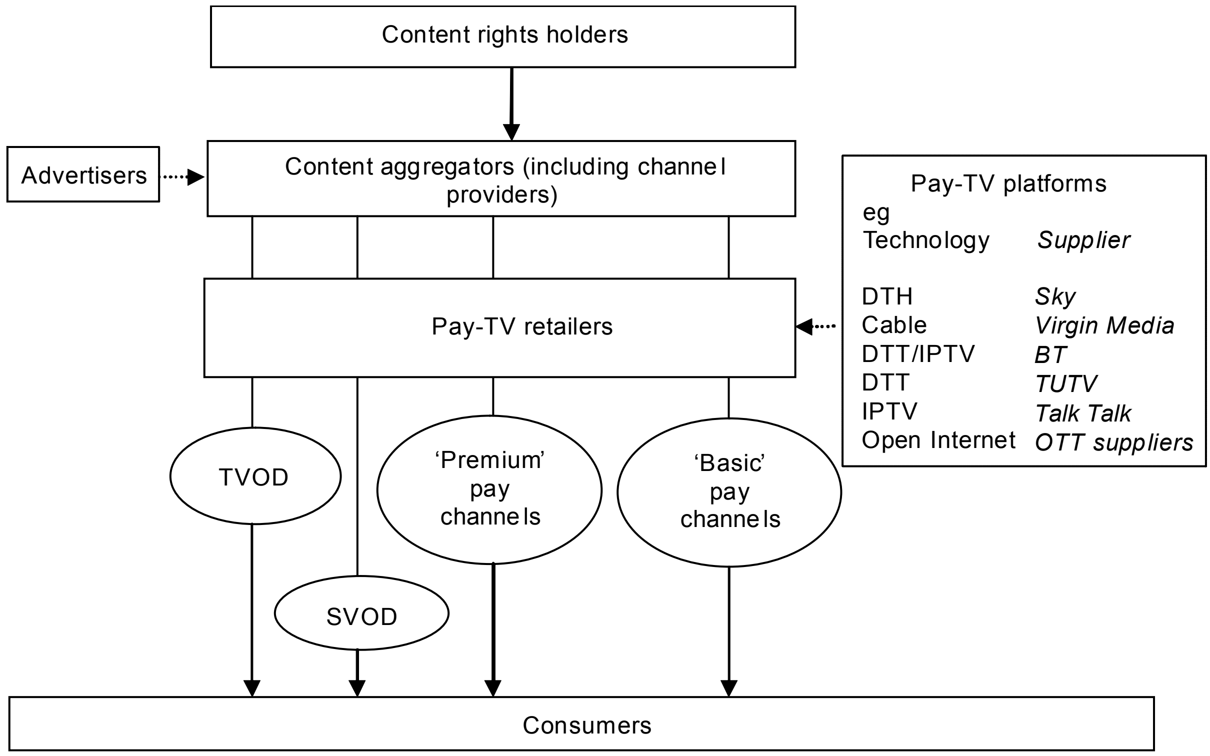
The UK pay-TV industry

2.12 Figure 2.1 shows the UK pay-TV supply chain.

[9] YouView employs similar technology.
[10] FTA terrestrial TV is also available on pay-TV services using DTT (ie BT Vision or TUTV).
[11] In addition, owners of Freeview STBs may opt for certain pay-TV services. This requires the purchase of a card-enabling conditional access which slots into the STB.
[12] www.freesat.co.uk/how-to/use-your-sky-dish.
[13] In July 2012, YouView had a media launch of its service and announced that it was in trials with 2,200 users. YouView announced that its service would be available to consumers in 2012..
[14] It is expected that a number of manufacturers will produce YouView STBs which consumers will be able to purchase from a number of retail outlets or from an ISP as part of a broadband package. Consumers will be able to use these STBs to access VOD content and other services over the Internet from a variety of providers.

FIGURE 2.1

Pay-TV supply chain



Source: CC.
Notes:
1. Solid lines represent pay-TV supply relationships and dotted lines other relevant supply.
2. In this figure we have used the term content aggregation to cover a range of activities including, for example, the production of channels.
3. OTT suppliers include those pay-TV platform operators who also provide OTT services, for example Sky (Sky Go and Now TV) and Virgin Media (Virgin player).
4. For these purposes and in the interests of clarity, we also illustrate TVOD within the pay-TV supply chain.

Overview of the pay-TV retailers

2.13 The three largest retailers of pay-TV linear channels in the UK are Sky, Virgin Media and BT Vision. These pay-TV retailers provide their pay-TV services through different delivery mechanisms (principally DTH, cable and DTT/IPTV respectively). Smaller operators include TalkTalk and TUTV. We refer to these providers as 'traditional pay-TV retailers' as they all supply their services principally over a proprietary pay-TV platform[15] as opposed to over the open Internet.[16] They also tend to offer pay-TV services (comprising linear channels as well as VOD) in packages of basic and premium products.

2.14 Most pay-TV retailers offer their pay-TV products as part of a bundled package which also includes non-TV products and services, such as telecommunications and broadband services (except for TUTV which does not provide telecommunications or broadband services). The bundling of pay-TV channels and other services together

[15] A pay-TV platform represents a specific combination of distribution and reception technology and conditional access which enables customers of traditional pay-TV retailers to view pay-TV content. Pay-TV platforms include an STB (or other device) and a viewing card which enable subscribers to view encrypted content. Conditional access is essential for a pay-TV channel since it needs to exclude STBs for which the appropriate payments have not been made.
[16] Sky's Anytime+ service, launched in October 2010, is delivered via the Internet.

into pay-TV products, and the bundling of these products with non-TV products and services, means that competition between pay-TV retailers can have many dimensions.[17]

2.15 In terms of coverage, Sky's satellite signal can reach 98 per cent of the population,[18] while cable is available mostly in large urban areas, reaching around half of UK households. BT Vision is available through all BT broadband-enabled exchanges,[19] while TalkTalk provides coverage only to homes near TalkTalk exchanges. Following digital switchover (ie by the end of 2012), Freeview will be able to reach 98.5 per cent of the population.[20]

2.16 In addition, a growing number of retailers sell pay-TV content on an SVOD, TVOD or EST basis (including, for example, LOVEFiLM, Netflix, Blinkbox (Tesco), KnowHow (Dixons), HMV, YouTube (Google) and Apple iTunes). These retailers distribute their content to consumers principally using the open Internet. Such OTT services can reach all homes with a broadband Internet connection, which is estimated to be 76 per cent of UK households,[21] and can be viewed on computers or on TVs with an Internet connection (either direct to the TV or through a device such as an STB or games console). OTT products can also be viewed on a wide range of mobile broadband Internet-connected devices, including tablets and smartphones. In the remainder of this report, we use the term OTT pay-TV retailer to refer to a provider of a subscription OTT pay-TV service, save where otherwise indicated.

Traditional pay-TV retailers

2.17 The traditional pay-TV retailers provide different tiers of channels or differentiated content. These can be broadly split into five types:

(a) FTA channels, providing a range of content, including movies, which are made available free at the point of access for viewers (BBC1, BBC2, ITV1, Channel 4 and Five are the main FTA channels, though there are many others);

(b) basic-package channels, which may also provide movies (eg Discovery, Disney Channel, Sky One, Living TV and Comedy Central);

(c) premium channels, which tend to include sports and movies and are generally sold as a more expensive option on top of a basic package of channels (eg the Sky Movies channels, the Sky Sports channels and ESPN, which can be bought by consumers in bundles or in some cases as single channels);

(d) stand-alone à-la-carte channels available individually and serving more specialist interests (eg focusing on ethnic or religious audiences, adult content or particular sports); and

(e) pay per view (PPV)/VOD services, supplied either on a subscription (SVOD) basis or on a transactional 'pay as you go' (TVOD or PPV) basis, offering particular movies or sporting events.

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[17] In recent years, Sky has grown significantly its so-called 'triple play' penetration (pay TV, Internet and fixed-line telephony) (see paragraph 2.26).
[18] There are several reasons why digital satellite coverage is not 100 per cent, including the local terrain and local planning rules.
[19] BT Vision's coverage is limited to homes where Freeview is available and the broadband line speed is sufficient.
[20] Northern Ireland is the last UK region subject to digital switchover, where it is due to start in October 2012.
[21] http://stakeholders.ofcom.org.uk/binaries/research/cmr/cmr12/CMR_UK_2012.pdf , pp4 & 25.

2.18 At the beginning of 1999, Sky and cable had a broadly similar number of pay-TV subscribers (ie 3.3 million and 3.0 million respectively). However, by the end of 2002, Sky had almost twice as many customers as cable (ie 6.2 million compared with 3.4 million customers) and, by the end of 2010, Sky had over 10 million subscribers (in the UK and the Republic of Ireland), while Virgin Media had less than 4 million. The development of Sky's business and the cable businesses (now mostly consolidated and operated by Virgin Media) is discussed in paragraphs 2.20 to 2.32.

2.19 We now provide an outline of the businesses and general retail offerings of the five traditional pay-TV retailers.

Sky

2.20 British Sky Broadcasting Group plc (Sky) is a multi-channel TV company and provider of telephony and broadband services created by the merger of Sky and BSB in 1990. Sky is listed on the London Stock Exchange and in 1995 it entered the FTSE 100 index. News Corporation, which is also the owner of Fox (see paragraph 2.60), owns 39.1 per cent of Sky.[22]

2.21 Sky launched digital TV in 1998 (the UK's first digital TV service, with over 140 channels) and its platform now offers a range of FTA, basic and premium channels. In terms of distribution, Sky principally uses satellite distribution, also known as direct-to-home (DTH), but also uses IPTV (for Anytime+) and the open Internet (for Sky Go and Now TV). Sky switched off its analogue satellite TV service in 2001.

2.22 Sky also provides the following services:

(a) Sky+ is Sky's PVR, which was launched in 2001. In 2007, Sky acquired Amstrad, a producer of its STBs. This is offered as part of a basic subscription to Sky.

(b) Sky Go, previously known as Sky Player, which allows Sky TV customers to access programming over the open Internet.[23]

(c) Other TV service enhancements, including HDTV, Multiroom (enabling Sky's TV services to be viewed on multiple TVs in a household), Sky Anytime (see paragraph 2.123) and Sky Anytime+ (see paragraphs 2.23 and 2.123).

(d) Sky Broadband, which was launched in 2006 following Sky's acquisition of Easynet in 2005. Sky now has nearly 4 million broadband customers. [24]

(e) Sky Talk, a fixed telephony business. Sky now has over 3.6 million fixed telephony customers. [25]

2.23 Sky launched its 'pull' VOD service, Sky Anytime+, in October 2010, offering movies and TV programmes on-demand. Content is requested by a subscriber and delivered

[22] We note that News Corporation has announced its intention to pursue the separation of its publishing and media and entertainment businesses into two distinct publicly traded companies, www.newscorp.com/news/news_535.html.
[23] This service was launched in 2008. It is also available on a stand-alone basis (the Sky Go monthly ticket), enabling customers to subscribe to watch a package of channels from Sky on a computer, an Xbox, or on some other Internet-connected STBs, without the need to install a satellite dish and Sky STB. However, there are few customers to Sky Go on this basis and most use of Sky Go is by subscribers to Sky's DTH service.
[24] http://corporate.sky.com/investors/press_releases/2012/sky_britains_number_1_choice.
[25] ibid.

to them on an IPTV basis using a broadband Internet service and the Ethernet port of Sky+ HD boxes.[26]

2.24 In July 2012, Sky launched a new stand-alone OTT service branded Now TV, as first announced in January 2012. Further information about this service is provided in paragraph 2.94. This service currently offers access to the entire Sky Movies collection and Sky has announced that it intends to expand the service to include sports and other entertainment content in due course.

2.25 Sky is the largest provider of pay TV in the UK, having grown its subscriber base consistently since 2000. At the end of May 2012, Sky had approximately 9.5 million pay-TV subscribers in the UK. In the year ended 30 June 2011, Sky had annual average revenue per user (ARPU) of £539.

2.26 By May 2012, Sky's triple-play penetration (pay TV, Internet and fixed-line telephony) had increased to approximately a third of its pay-TV subscriber base with more than 3.2 million customers taking a triple-play product.

Virgin Media

2.27 Virgin Media Inc (Virgin Media) is a provider of TV, telephony and Internet services in the UK. It is a Delaware corporation, publicly traded on the NASDAQ Global Select market in the USA (its primary listing) and on the London Stock Exchange in the UK (as a secondary listing).

2.28 Virgin Media is by far the largest cable operator in the UK, and Virgin Media cable passes just over 50 per cent of UK homes. Virgin Media offers a wide range of FTA, basic and premium channels, and a VOD 'pull' on-demand service which includes both free and pay-TV content. At the end of May 2012, Virgin Media had approximately [✂] million subscribers to its TV services.

2.29 In 2006, ntl Incorporated and Telewest Global Inc merged, forming ntl:Telewest, which was the culmination of 13 years of consolidation among the cable franchise areas. In July 2006, the merged entity then acquired Virgin Mobile to become capable of offering a 'quadruple play' (or quadplay) of pay TV, Internet, fixed-line telephony and mobile telephony. At the same time, it acquired the rights to the Virgin brand in a 30-year licensing agreement and, in 2007, the company relaunched as Virgin Media.

2.30 Virgin Media's pay-TV service offers many similar attributes to that of Sky, for example both linear and VOD content, a PVR, multi-room functionality, HD content, etc. A key difference is that Virgin Media is no longer a producer of linear channels but rather it retails packages of channels which are licensed from others, including Sky Movies, as well as offering a VOD service. Virgin Media also offers a next generation STB, powered by TiVo, which, among other things, offers 'through the middle' content, applications and extensive search functionality.

2.31 At the end of 2011, Virgin Media's quadplay penetration had increased to approximately [✂] per cent of its subscriber base, and its triple play penetration (pay TV, Internet and fixed-line telephony) had increased to [✂] per cent.

[26] Until March 2012, Sky Anytime+ was only available to customers of Sky broadband; however, since March 2012, customers can use any broadband service to access it (so long as they have the necessary Sky pay-TV subscription and hardware).

2.32 In 2011, Virgin Media had annual ARPU of approximately £[✂].[27]

BT Vision

2.33 British Telecommunications plc (BT) is a communications services provider in the UK whose main activities are the provision of fixed lines, broadband, mobile and TV products and services, as well as networked IT services.

2.34 BT is made up of four principal businesses:

(a) BT Retail serves consumers and small and medium enterprises in the UK, and includes BT Vision. BT Retail also includes BT's business in the Republic of Ireland.

(b) BT Wholesale provides services to UK communications providers.

(c) Openreach is responsible for the access and backhaul elements of BT's network, the 'last mile', and provides services connecting communications providers' customers to their local telephone exchange.

(d) BT Global Services serves customers across the world, providing networked IT services.

2.35 As at 31 March 2011, BT Retail had 10.5 million active consumer telephone lines (ie lines for which it is the call provider) and BT Retail achieved an annual ARPU of £326 from its UK consumers. At that time BT had a 27 per cent share of UK consumer and small business broadband customers.

2.36 BT Vision launched in December 2006 using both DTT and IPTV technology. BT Vision offers linear TV channels on Freeview via DTT, including paid-for Sky sports channels, and on-demand content via IPTV.

2.37 BT Vision's on-demand TV service gives access to free-to-view content (including catch-up on four of the five main channels) and paid-for content. BT Vision offers a subscription movies service, branded Vision Film.

2.38 As at 31 May 2012, BT Vision had just over [✂] subscribers.

Top Up TV

2.39 TUTV provides paid-for services, both linear and on-demand, using DTT. It offers consumers paid-for linear channels (eg ESPN) and VOD services, including movies, with content being downloaded to the hard drives of the customer's PVR overnight.

2.40 TUTV launched in 2004 and currently sells about [✂].

TalkTalk TV

2.41 TalkTalk TV began initially as Homechoice in 1999. In 2004, Homechoice began providing linear channels. In 2006, the Internet service provider Tiscali acquired HomeChoice and, in 2009, Carphone Warehouse acquired Tiscali UK, rebranding the service in line with its TalkTalk brand. In 2010, TalkTalk (including the TalkTalk

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[27] Annual ARPU figure calculated as the sum of the average monthly figures reported each quarter multiplied by three.

TV business) was demerged from Carphone Warehouse, becoming an independent company.

2.42 TalkTalk TV offers both linear TV channels and a range of on-demand content via IPTV. Its STBs also include a DTT tuner. As at May 2012, TalkTalk TV had [✂] pay-TV subscribers. TalkTalk has announced that it intends to relaunch its pay-TV business in 2012, using YouView-compatible STBs (see paragraph 2.102).

OTT pay-TV retailers

2.43 One of the developments that is changing how movies are watched and the choices available to consumers when choosing pay-TV providers is that consumers can now access premium movie content over the open Internet, ie OTT (see paragraph 2.16).

2.44 In December 2011 and January 2012 respectively, LOVEFiLM and Netflix launched stand-alone OTT SVOD services offering streamed movies and previously-broadcast TV programmes and, in their first few months, these services achieved rapid growth.

2.45 In this subsection we provide an outline of the businesses and general retail offerings of LOVEFiLM and Netflix (with more detail on their offerings set out in Appendix 4.2).

LOVEFiLM

2.46 LOVEFiLM, founded in 2004, is a film and entertainment service provider in the UK, Germany, Sweden, Denmark and Norway, with over 2 million subscribers. In February 2011, Amazon, the US-based online retailer with total assets of over $25 billion, acquired full control of LOVEFiLM. Amazon told us that [✂].[28]

2.47 LOVEFiLM's two principal services in the UK are LOVEFiLM By Post, which offers access to over 70,000 DVDs and Blu-ray discs to rent by post, and a film and TV streaming service, branded LOVEFiLM Instant, which, in the UK, offers access to several thousand titles (movies and TV episodes). LOVEFiLM also offers access to content on a TVOD basis via LOVEFiLM Box Office and video games rental by post.

2.48 LOVEFiLM Instant is available on over 175 Internet-enabled devices including PCs, the PS3, Apple's iPad, the Xbox 360, and a growing number of Blu-ray disc players and Internet-connected TVs including Sony Bravia, Samsung and Cello.

2.49 Over recent months, LOVEFiLM has entered into a number of contracts to provide additional movie and previously-broadcast TV content through its streaming service. LOVEFiLM's movie offering is discussed in more detail below.

2.50 At 31 May 2012, LOVEFiLM had approximately [✂] paying subscribers in the UK, of which almost [✂] were paying users of its unlimited streaming service (up from [✂] prior to the developments in its business in December 2011). In the year ended 31 December 2011, LOVEFiLM had a monthly ARPU of £[✂].

Netflix

2.51 Netflix Inc was founded in 1997 and was listed on the Nasdaq stock exchange in 2002. Netflix launched its movie and TV programme SVOD service in the USA in 2007, extending it to Canada in September 2010, to Latin America and the

[28] Amazon is listed on the Nasdaq stock exchange.

Caribbean in September 2011, and to the UK and the Republic of Ireland in January 2012. The UK Netflix subscription service offers several thousand titles (movies and TV episodes) distributed over the open Internet.

2.52 Netflix's services are available on over 700 devices, including the Xbox 360, Wii and PS3 games consoles, many Blu-ray disc players, Internet-connected TVs, home theatre systems, PVRs and Internet video players, Apple TV and Google TV, and the Apple iPhone, iPad and iPod touch. In the USA, Netflix also offers a DVD rental by post service.

2.53 Netflix had over 23 million streaming members worldwide at the end of 2011. At 31 May 2012, just five months after launch, it had [✂] paying subscribers in the UK and Republic of Ireland.

Provision of movie content to pay-TV providers

2.54 In this subsection, we describe briefly the six largest Hollywood studios, which are responsible for licensing the majority of movie content (by box office share) and some of the smaller studios. We then describe the window release structure through which movie content is licensed by the studios to different parties. Lastly we discuss the importance of UK pay TV to the six largest studios.

The major and non-major studios

2.55 The six largest Hollywood studios are Paramount, Universal, Fox, Warner, Disney and Sony Pictures (including the subsidiaries and affiliates of these companies). We refer to these six studios as the 'major' studios. We refer to studios other than the six major studios as 'non-major' studios.

2.56 The distinction between major and non-major studios appears to be widely recognized in the industry. In particular, over the long term, the average market shares of the major studios have been markedly above the average market shares of the non-major studios (see Appendix 3.1, Table 4). However, in years when the movies of a non-major studio enjoy particular success, that studio may achieve a market share comparable to the market share of a major studio.

2.57 We summarize first the businesses of the six major studios, which are referred to in our terms of reference and from which Sky obtains the majority of its movie content. We then describe,the businesses of some of the largest non-major studios, in particular some of those studios which have licensed their content for exhibition on the OTT services of LOVEFiLM and Netflix in the UK.

Major studios

- *Paramount*

2.58 Paramount is a unit of the global entertainment company, Viacom Inc. Paramount consists of several film labels, including Paramount Pictures, MTV Films, Nickelodeon Movies, Paramount Vantage and Paramount Classics. In addition, Paramount also has a distribution deal with DreamWorks Animation.

- *Universal*

2.59 NBC Universal (Universal) was created in 2004 by the merger of NBC, owned by the General Electric Company (GE), and Universal Entertainment, owned by Vivendi SA (Vivendi). A GE holding company currently owns approximately 88 per cent of Universal, with Vivendi owning the remaining 12 per cent. In December 2009, GE, Universal and Comcast Corporation (Comcast) formed a joint venture, owned 51 per cent by Comcast and 49 per cent by GE, consisting of the businesses of Universal and its subsidiaries, together with certain cable networks, regional sports networks and digital media properties owned by Comcast.

- *Fox*

2.60 Fox Entertainment Group Inc (Fox) is a subsidiary of News Corporation (which also owns approximately 39 per cent of Sky (see paragraph 2.20)). Fox Entertainment Group Inc is the parent company of Twentieth Century Fox Film Corporation.

- *Warner*

2.61 Warner Bros International Distribution Inc (Warner) is owned by Warner Bros Entertainment Inc, which in turn is a Time Warner company.

- *Disney*

2.62 Walt Disney Studios Motion Pictures (Disney) distributes feature films produced and/or released by the following entities: Walt Disney Pictures (which includes Walt Disney Animation Studios, Pixar Animation and DisneyToon Studios), Touchstone Pictures, Hollywood Pictures and Disneynature.

- *Sony Pictures*

2.63 Sony Pictures Entertainment Inc (Sony Pictures) is a subsidiary of Sony Corporation of America, a subsidiary of Sony Corporation. Its movie businesses include Columbia Pictures, Sony Pictures Classics, Screen Gems and TriStar Pictures.

Non-major studios

- *MGM*

2.64 Metro-Goldwyn-Mayer Inc (MGM) is an independent film, TV, home video and theatrical production and distribution company. Its library of approximately 4,000 titles and over 10,500 episodes of TV programming consists of titles from the United Artists, Orion Pictures, Goldwyn Entertainment and PolyGram Filmed Entertainment libraries. MGM is a partner in EPIX (along with Lionsgate and Paramount).

- *Lionsgate*

2.65 Lionsgate is a diversified global entertainment corporation and listed on the New York stock exchange. It has expanded significantly in the past ten years both through organic growth and acquisitions, for example acquiring Redbus Film Distributors in the UK in October 2005 (now Lionsgate UK) and Artisan Entertainment and Trimark Holdings in the USA.

- *Entertainment One*

2.66 Entertainment One Television (eOne) is a production, international sales, licensing and merchandising business operating in Canada, the UK, Benelux and the USA. eOne is listed on the London Stock Exchange.

- *Momentum*

2.67 Momentum Pictures (Alliance Films (UK) Limited) (Momentum) is an independent film distributor and production company in the UK and Republic of Ireland and an affiliate of Alliance Films Inc, a Canadian film distribution and production company.

- *Studiocanal*

2.68 Studiocanal is a UK-based production and distribution company and is part of the Canal+ Group, owned by Vivendi SA.

Movie release windows

2.69 Movies are sold in different formats in discrete or overlapping release 'windows'. Typically, a movie is first released in cinemas, then on DVD (or home video), then for TVOD (ie for a one-off fee),[29] then on subscription pay TV (both linear channels and SVOD) and finally on FTA TV. [30] After a film has progressed through these windows, it is categorized as a library film, at which point it may be exhibited on pay TV and/or FTA TV and/or made available again for TVOD. We describe the structure of movie windows more fully in Appendix 4.8

2.70 The emergence of the OTT services of LOVEFiLM and Netflix, which occurred during the course of our inquiry, changed the way in which movies are licensed for exhibition on subscription pay TV. Previously, Sky had licensing agreements with all the major studios and many non-major studios for their FSPTW rights, and BT's Vision Film and PictureBox had licensing agreements with some major studios and non-major studios for their SSPTW rights. Some movies also went directly from the DVD/ TVOD windows to FTA TV. Due to the additional interest in licensing movies for exhibition on subscription pay-TV services from LOVEFiLM and Netflix, there is now considerably more content licensed in an SSPTW, and a TSPTW has emerged.

2.71 In most windows, 'hold-back' constraints restrict the extent to which the same movie can be distributed in other formats at the same time (eg a movie in the FSPTW cannot be viewed on FTA TV and often cannot be viewed on TVOD). However, certain windows continue to run indefinitely once they have started (eg the DVD window). In some cases, a 'blackout' period creates a gap between release windows (eg in the UK, typically, a film ceases to be available on a TVOD basis approximately 60 days before it becomes available in the FSPTW).

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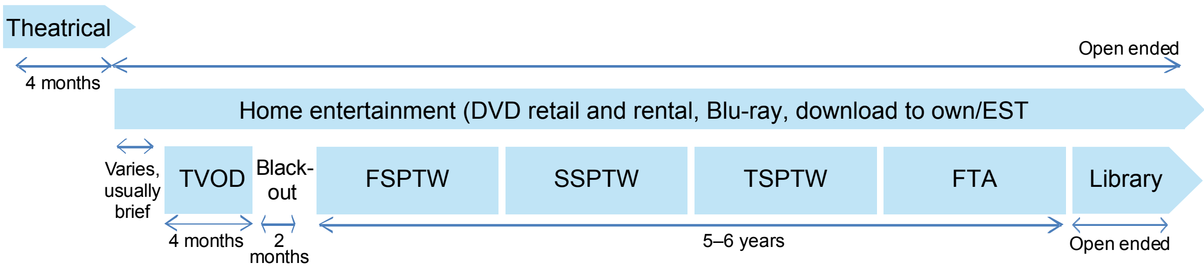
[29] We considered download-to-rent (DTR) to be a comparable service to TVOD and our references in this report to TVOD should be read as relating also to DTR. We also did not see much distinction between whether a movie was streamed (ie transmitted to a device as the viewer watches the movie) or whether it was downloaded (either complete download prior to viewing or progressive download such that the movie continues to download as the viewer begins watching). We refer to all services whereby a consumer pays a transactional fee in order to watch one movie which is provided to the consumer electronically in response to the consumer's request, and which they do not own (though they might be able to view it on multiple occasions over a brief period), as TVOD. We noted that, typically, all such services were available in the same window, indicating that the studios also made little distinction. We noted that two closely-related products were PPV, when a consumer pays a fee to watch a broadcast movie at a set time in a linear schedule, and near video on demand (NVOD), when a movie is broadcast and stored on consumers' PVR and which a consumer can then pay to watch.

[30] For some movies distributed by some studios, TVOD sales also occur concurrently with some or all of the pay-TV and FTA windows.

2.72 Figure 2.2 shows the release windows for a movie in the UK. It should be noted that the duration of the FSPTW, SSPTW, TSPTW and FTA window varies between studios and between movies, with some movies not licensed in all windows (eg straight to DVD movies) and some studios not licensing in all windows (eg some license content in the FSPTW and then the FTA window, with no SSPTW or TSPTW).[31]

FIGURE 2.2

Typical release windows for a movie in the UK



Source: CC (not to scale).

Significance of UK pay TV to the major studios

2.73 The UK is a significant geographic market for the major studios. In 2010, the USA accounted for over 40 per cent of the revenue generated worldwide from filmed entertainment (excluding TV revenues) but the UK was the third-largest market, after Japan. Table 2.1 shows the gross amount spent by consumers on filmed entertainment by territory (including taxes and the margins earned by exhibitors and distributors, but excluding TV revenues).

[31] For some movies distributed by some studios, TVOD sales also occur concurrently with some or all of the pay-TV and FTA windows (see second footnote to paragraph 2.69). This is not shown on the diagram.

TABLE 2.1 **Filmed entertainment revenues by country/region, 2010**

Country/region	*Revenue US $m*	*Percentage of total*
USA	35,200	40.8
Japan	7,674	8.9
UK	5,809	6.7
Other Western Europe	5,031	5.8
France	3,805	4.4
Canada	3,770	4.4
Australia	3,622	4.2
Germany	3,528	4.1
Other Asia Pacific	3,129	3.6
Italy	2,057	2.4
China	1,969	2.3
India	1,855	2.2
South Korea	1,541	1.8
Russia	1,533	1.8
Brazil	1,368	1.6
Spain	1,158	1.3
Mexico	1,146	1.3
Other Central & Eastern Europe	898	1.0
Middle East & Africa	570	0.7
Other Latin America	559	0.6
Total	86,222	100.0

Source: *British Film Institute Statistical Yearbook 2011*.

Note: In this table, 'filmed entertainment revenue' includes box office receipts, home DVD/video (rental and retail) and Internet download and streaming revenues, but does not include TV revenues.

2.74 The British Film Institute has estimated that the UK will remain in the same position until at least 2015 (accounting for about 6.4 per cent of total international filmed entertainment revenues).[32]

2.75 In the UK, the pay-TV sector is a significant, but not the largest, source of revenue for the major studios. Figure 2.3 shows the value to these studios of different movie distribution channels in the UK.

FIGURE 2.3

UK filmed entertainment revenue of the six largest Hollywood studios in 2009 in the UK, nominal figures (million)

[✄]

Note: Home entertainment includes DVDs, Blu-ray and EST. Some basic pay TV included in Free TV category.
Source: CC analysis of data from the six major studios.

2.76 In 2009, 'home entertainment' revenues (eg DVD and Blu-ray disc retail and rental) represented almost [✄] the major studios' revenue in the UK, with [✄] cinematic exhibition, FTA TV and pay TV. Total revenues for the major studios from movies shown on TV in the UK amounted to $[✄] million. Subscription pay TV (ie linear movie channels and SVOD services rather than TVOD services) generated $[✄] million, representing over [✄] per cent of the total revenues derived from movie content in the UK.

2.77 As the licensee of the FSPTW content of all of the major studios, Sky is the studios' principal pay-TV broadcast customer. However, the acquisition of FSPTW movie

[32] *British Film Institute Statistical Yearbook 2011*.

content is far from Sky's largest item of expenditure on content. In the year ended June 2011, Sky spent approximately £[✂] million acquiring FSPTW movie rights (and a further £[✂] million on other movie rights), compared with around £[✂] on sports content and £[✂] million on TV channels excluding news, sports and movies.[33]

2.78 Overall, Sky pays [✂] per cent of its expenditure on movie rights to the six major studios (as shown in Table 2.2).

TABLE 2.2 **Sky Movies programming costs**

[✂]

Source: Sky.

2.79 Sky's expenditure on movie rights in 2010/11 was [✂] than in the previous year [✂] (see paragraph 2.70).

Provision and consumption of movies on TV

2.80 In this subsection, we discuss how movies are provided and consumed. We describe linear TV movie services, home video services and VOD and EST movie services. We describe in particular detail the Sky Movies service, which is the only pay-TV service with the FSPTW content of major studios.

Overview of movie consumption

2.81 Most movie viewing takes place at home, rather than at the cinema, and is predominantly via linear TV channels. Table 2.3 presents estimates of the number of people viewing movies in the UK in 2010 at the cinema, on home video (ie DVD/Blu-ray), on VOD and on linear TV channels.

TABLE 2.3 **The movie audience, 2010**

Mode	*Audience size m*	*% of viewings*
Cinema	169	4
Home video	719	16
VOD	53	1
Film on linear TV	3,668	80
Total	4,609	100

Sources: CAA, Rentrak EDI, FAME, *Screen Digest*, Attentional, RSU analysis, from *British Film Institute Statistical Yearbook 2011*.

Notes:
1. Home video includes occasions watching previously-purchased movies as well as current purchases. The home video estimate is derived from FAME survey information on the home-video-watching habits of cinema-goers with an additional estimate for the population not covered by FAME.
2. 'Film on TV' includes terrestrial, subscription and FTA multi-channel.

2.82 In 2010, the audience for movies on linear TV channels was five times the audience in the next largest category, which was home video[34] (ie DVDs and Blu-ray discs).[35] VOD (not including time-shifted or catch-up VOD (eg on the BBC iPlayer)) accounted

[33] In July 2012, the FAPL announced that it had licensed to Sky five of its seven packages of rights for the three seasons from 2013/14 at a total cost of £2.3 billion.
[34] *British Film Institute Statistical Yearbook 2011.*
[35] We use the terms 'home video' or 'home entertainment' to encompass all physical storage media including DVD and Blu-ray discs.

for less than 1 per cent of the total movie audience.[36] However, as a whole, home video remained the most valuable distribution format to the movie studios (see Figure 2.3).

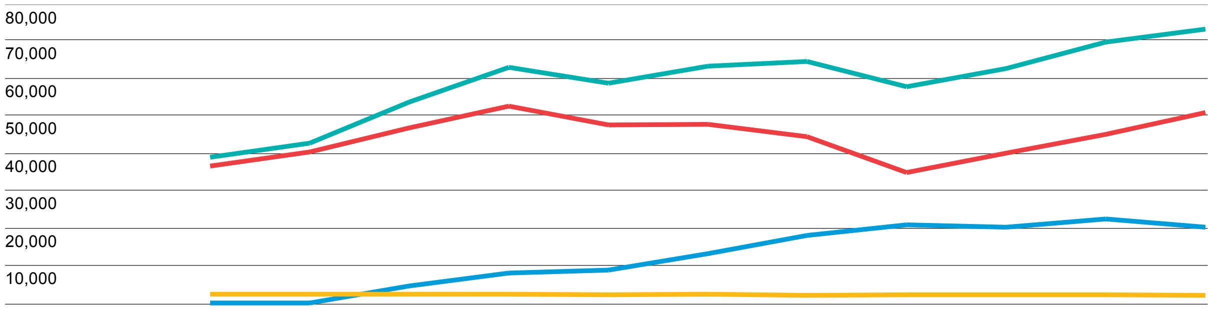
Linear TV movie services

Movie transmissions

2.83 Movie transmissions on linear TV have increased significantly in the last ten years with the growth in the number of digital FTA TV channels. However, subscription pay-TV movie channels still account for the largest number of movie transmissions on TV, as shown in Figure 2.4.

FIGURE 2.4

The total number of film transmissions on all TV channels (except NVOD), 2000 to 2010



	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Terrestrial	2,318	2,405	2,275	2,355	2,234	2,326	2,011	2,182	2,221	2,218	2,075
Subscription film channels	36,547	40,277	46,720	52,552	47,499	47,698	44,346	34,737	40,014	45,015	50,756
Other digital multi-channel	0	0	4,573	7,900	8,821	13,144	17,998	20,765	20,274	22,359	20,174
Total	38,865	42,682	53,568	62,807	58,554	63,168	64,355	57,684	62,509	69,592	73,005

Source: British Film Institute Statistical Yearbook 2011.
Notes:
1. 'Terrestrial' refers to the five PSB channels by whichever means they are broadcast.
2. NVOD is where the same content is broadcast on a number of different linear channels at staggered start times.

2.84 Between 2000 and 2010, the total number of movie transmissions[37] on TV increased by over 80 per cent. The number of movie transmissions on subscription (ie pay-TV) movie channels in this period as a whole rose by approximately 25 per cent, having fallen between 2003 and 2007. However, the number of movie transmissions on 'other digital multi-channels' (ie FTA channels other than the five PSB channels (eg BBC 4, ITV 3, FilmFour, etc)) grew more than fivefold between 2002 and 2010. Despite this, the number of movie transmissions on 'other digital multi-channels' in 2010 was still only half the number on pay-TV movie channels.

[36] *British Film Institute Statistical Yearbook 2011.*
[37] Not the same as the number of movie titles shown, as the same title may be broadcast more than once.

Linear movie services available on traditional pay TV in the UK

2.85 We now describe the principal linear movie services offered by the traditional pay-TV retailers within their bundled packages of pay-TV.[38]

- *Sky*

2.86 Sky's dedicated movie service, provided principally via its DTH platform, is Sky Movies, which comprises 12 broadcast SD movie channels (including the Disney Cinemagic channel).

- *Content*

2.87 The movie content exhibited on Sky Movies is licensed from all six of the major studios as well as a number of non-major studios.[39] This content is generally either in the FSPTW or library window.

2.88 Since 2007 the majority of Sky's movie channels have been dedicated to particular genres of movies with the Sky Movies Premiere channel showing the most recent movies in the FSPTW, while the Sky Movies Classics and Sky Movies Modern Greats channels show mainly library movies.

- *Packs and products*

2.89 Sky Movies is offered to consumers in two packs, 'single movies' and 'dual movies', as follows:

(a) The single movies packs are Sky Movies 1 and Sky Movies 2, each of which is a group of five channels but does not include the Sky Movies Premiere channel or the Sky Movies Showcase channel:

(i) Sky Movies 1: Sky Movies Comedy, Sky Movies Family, Sky Movies Classics, Sky Movies Modern Greats, Sky Movies Drama and Romance; and

(ii) Sky Movies 2: Sky Movies Comedy, Sky Movies Action and Adventure, Sky Movies Sci-Fi and Horror, Sky Movies Indie, Sky Movies Crime and Thriller.

(b) The dual movies pack consists of all Sky Movies channels (including the Sky Movies Premiere and Sky Movies Showcase channels, which are not included in either of the single movies packs) and Disney Cinemagic.

2.90 Subscribers to Sky's dual movies pack can also view about 600 of the movies exhibited on Sky Movies' linear channels on an SVOD basis (as part of Sky's Anytime+ service).[40] These movies are also available in the Anytime+ area of Sky Go and on Now TV.[41]

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[38] Further details of the linear services offered by the traditional pay-TV retailers are provided in Appendix 2.1. Neither BT nor TUTV offers a linear movie service within their bundled packages of pay TV.
[39] Until recently, no pay-TV movie service other than Sky Movies offered much FSPTW content. As such, there was little content available from movie studios for Sky to license which had already been shown on pay TV.
[40] The SVOD content on Sky Anytime+ and Now TV is offered alongside Sky's linear channels and is not available under an SVOD-only subscription. Therefore, we discuss both the linear and SVOD aspects of Sky Movies here.
[41] At any point in time, not all of the movies which are available for exhibition on Sky Movies' linear channels are available on an SVOD basis due to restrictions in Sky's SVOD licensing agreements with the studios (eg due to limitations in the number of days on which the movie can be made available on an SVOD basis during the licence window or due to a shorter licence

2.91 Sky's HD subscribers receive HD versions of the SD channels in their package.[42]

2.92 Sky retails its movie packs alongside and together with both of its single and dual sports packs.[43] We refer to these as the Sky Movies products (single movies, dual movies, single movies/single sports, single movies/dual sports, dual movies/single sports and dual movies/dual sports).

- *Distribution*

2.93 In addition to being distributed over Sky's DTH platform (and IPTV for the distribution of VOD content), Sky offers Sky Movies over the open Internet via Sky Go.[44] Sky Go can be viewed using the Xbox360, Fetch TV STBs, PCs and certain mobile devices (iPhones, iPads and some Android devices). Sky Go provides Sky Movies DTH subscribers with an additional way of viewing Sky Movies but, currently, has relatively few stand-alone (ie non-satellite) subscribers.[45]

2.94 Since July 2012, Sky has also offered Sky Movies on Now TV, its new OTT service which, like Sky Go, is distributed over the open Internet. Since launch, Now TV has been available on devices including PCs, Macs and selected Android smartphones, with iPhone, iPad, Xbox, Roku streaming players and the PS3 scheduled to follow. Sky Movies is available on this service without requiring a subscription to a basic package of pay TV at a price of £15.[46] Unlike Sky Go, which is principally a complementary service offered at no incremental price to Sky's DTH subscribers, Sky is marketing Sky Movies on Now TV on a stand-alone basis. The content available on Sky Movies through Now TV, both on linear channels and by SVOD, is the same content as is available to Sky's dual movies DTH customers, with the exception of Disney Cinemagic and MGM HD which are only available to Sky's DTH customers (or dual movies customers on Virgin Media). Sky told us that Now TV would offer two other products in addition to Sky Movies: content from Sky Sports (by the end of 2012) and, in due course, a range of content from Sky's Entertainment channels (including Sky 1, Sky Atlantic and Sky Living). Sky told us that [✂]. Sky said that [✂].

2.95 Sky also supplies Sky Movies to other traditional pay-TV retailers on a wholesale basis,[47] in particular Virgin Media. As a result, Virgin Media retails the same Sky Movies products as Sky. Some smaller cable pay-TV providers such as Wightcable also retail Sky Movies, although the packs they offer do not generally include all the Sky Movies channels or its SVOD content. Currently, Sky also retails its Sky Movies Premiere channel and some other channels via TalkTalk's platform (branded Sky by Wire), [✂] there are [✂] Sky by Wire subscribers. However, Sky told us that it had reached agreement with TalkTalk for the wholesale carriage of all the Sky Movies channels in SD for delivery over TalkTalk's broadband network to YouView-

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window than applies to linear exhibition). Sky Anytime+ also includes significant amounts of non-movies content. Sky Anytime+ requires a Sky HD box.

[42] Subscribers to Sky's DTH service who subscribe to Sky Movies with HD also receive the MGM HD channel.

[43] Since September 2011, packages incorporating single movies or single sports have not been available to new subscribers from Sky's call centre but have continued to be available from Sky's website.

[44] Sky Go offers both the Sky Movies linear channels (with the exception of Sky Premiere+1) and the Sky Movies VOD content.

[45] Sky offers access to some of its channels and to its on-demand content separately from its satellite service via a Sky Go monthly ticket. Sky told us that it had nearly [✂] subscribers on a Sky Go monthly ticket.

[46] Although consumers can access Sky Go on a monthly ticket, the cost of this service is similar to (but slightly lower than) that of a subscription to Sky's DTH service.

[47] All the traditional pay-TV retailers retail the majority of the pay-TV content available on their platforms, which they either create (in the case of Sky) or acquire on a wholesale basis, though there are a few exceptions (eg the Sky by Wire service on the TalkTalk platform (see paragraph 2.95)). Sky's platform is open to other retailers (see Appendix 5.1) [✂], there are [✂] subscribers to third parties' services on Sky's platform. Sky told us that this reflected the predominantly niche nature of such services.

compatible STBs.[48] Sky and BT both told us that they were in discussions about the wholesale supply by Sky to BT of Sky Movies (see Section 8).

2.96 Table 2.4 shows the estimated number of UK households with subscriptions to pay TV and the number taking a Sky Movies product at the start of 2012.

TABLE 2.4 **UK households' main TV service, and subscribers to Sky Movies channels, January/February 2012**

Rough estimates, million

	*Total**	*Total Sky Movies*	*Dual movies without Sky Sports*	*Dual movies with Sky Sports*	*Single movies*
Households with pay TV					
Satellite—pay (Sky)	9.6	[✂]	[✂]	[✂]	[✂]
Cable	4.1†	[✂]	[✂]	[✂]	[✂]
Other—pay‡	1.1				
Total	14.8	[✂]	[✂]	[✂]	[✂]
Households without pay TV					
DTT—Freeview	9.4§				
Satellite—Freesat	0.5				
Satellite—other	0.7¶				
Analogue	0.6#				
Total	11.1				
Grand total	26.0	[✂]			

Source: CC estimates based on data from Ofcom's Nations and Regions Tracker for Q1 2012, 4 January to 27 February 2012 (for total number of households), and data from pay-TV providers (for number of households taking Sky Movies).

*We multiplied the total number of households in the UK by the percentage of respondents saying that they used each type of TV service as their main type of TV service from Tables 84 and 90 of Ofcom's Nations and Regions Tracker for Q1 2012. We assumed a total of 26.4 million households in the UK (Source: ONS Families and Households Data Table 5, figure for 2011 Q2 plus estimated growth). 2 per cent of respondents said that they had no TV in their household: this suggested that there were 26.0 million households with TV.
†Total includes subscribers to Virgin Media's M-pack which does not include pay-TV channels (it offers subscribers access to PPV content and additional FTA channels). [✂]
‡Includes respondents saying that their main TV service was distributed via DTT but they were able to view pay channels such as ESPN, TV Favourites and PictureBox and respondents saying that their main TV service was via a broadband DSL line (eg BT Vision or TalkTalk).
§Freeview total includes respondents saying that their main TV was Freeview, with only free channels, and respondents saying that their main TV was terrestrial TV.
¶Former Sky subscribers still using their STBs, and other satellite services showing mainly non-English programmes.
#Analogue total reflects respondents saying that they used only terrestrial TV (Channels 1–4/1–5).
Note: Totals may not equal sum of constituents due to rounding.

2.97 The number of Sky's pay-TV subscribers has increased consistently for many years (see Figure 5.1 in Section 5). The number of subscribers to Sky Movies [✂].

- *Prices*

2.98 The pricing of Sky Movies is complex as both Sky and Virgin Media make Sky Movies available as part of a pay-TV package with other services, including basic channels.[49] Table 2.5 (top panel) shows the prices charged in March 2012 for packages of pay TV including Sky Movies products.[50] A comparison of prices is made more difficult by the bundling of communications products (line rental and broadband) with pay-TV services (known as 'triple play'). However, to enable com-

[48] [✂]
[49] With the exception of Sky Movies on Now TV. From September 2009 to August 2011, it was possible to purchase Sky Movies on the Sky platform without basic channels from Sky's call centre for a reduction of £1 per month compared with the price with one entertainment pack. However, it appeared to us that awareness of this option was likely to have been low as it was not actively marketed by Sky and, as at September 2010, it had been taken up by [✂] per cent of Sky Movies subscribers.
[50] Table 2.5 shows prices for packages including four different Sky Movies products. The other two Sky Movies products (single movies with dual sports and dual movies with single sports) are omitted for reasons of space and because there are few subscribers to these products.

parability, Table 2.5 is based on prices for a subscriber taking just pay TV (though the notes make reference to some of the communication products available).

2.99 As we focused in our inquiry specifically on movies on pay TV, rather than pay TV generally, a key question was the price to customers of Sky Movies products, rather than the price of other services.[51] Therefore, we considered the incremental price of Sky Movies products, defined as the difference between the cost of a package including the Sky Movies product and the cost of the same package without the Sky Movies product.[52]

[51] Our terms of reference refer to the wholesale supply and acquisition of 'packages' including Sky Movies channels. There are six wholesale 'packages' including Sky Movies channels: single movies, dual movies, and each of these combined with each of single sports and dual sports. No basic channels are included in wholesale 'packages' which include Sky Movies channels. The wholesale 'packages' referred to in our terms of reference are therefore the same as the Sky Movies products retailed by Sky and Virgin Media.

[52] We noted that it was likely that most consumers subscribing to Sky Movies products were willing to pay more than its incremental price, both because preferences of individual subscribers differ and only a few value their chosen product at precisely its incremental price (ie there is a downward sloping demand curve for each Sky Movies product), and also because some subscribers to Sky Movies products would value a basic-only package at less than its price. Given our definition of incremental price, if customers are willing to pay for a package including a Sky Movies product but not the comparable package without the Sky Movies product (the basic-only package), then they must be willing to pay more than the incremental price for the Sky Movies product.

TABLE 2.5 **Price of pay-TV packages and implied incremental price of Sky Movies, March 2012, excluding any connection/installation charges and introductory offers**

£ per month

Platform:	*Sky*	*Virgin Media*	*TalkTalk*	*Internet*	*Internet*
Retailer:	*Sky**	*Virgin Media†*	*Sky (Sky by Wire)*	*Sky (Sky Go)‡*	*Sky (Now TV)*
Total package prices					
Minimum basic channels§					
No movies, no sport¶	20.00	18.00			
Single movies#	28.00	32.50			
Single sport¶#	32.50	32.50			
Single movies & single sport#	38.75				
Dual movies	36.00	37.50			
Dual sport¶	40.00	40.50			
Dual movies and dual sport	48.00	47.50			
Maximum basic channels~					
No movies, no sport¶	25.00	35.50		15.00	
Single movies#	33.00	50.00			
Single sport¶#	37.50	50.00			
Single movies & single sport#	43.75				
Dual movies	41.00	55.00		32.00	
Dual sport¶	45.00	58.00		35.00	
Dual movies & dual sport	53.00	65.00		40.00	
Implied incremental price of Sky Movies products (price of Sky Movies package less price of basic package)					
Single movies#	8.00	14.50	22.00★		
Single movies & single sport#	18.75				
Dual movies	16.00	19.50		17.00	15.00
Dual movies and dual sport	28.00	29.50		25.00	

Source: CC calculations.

*Sky provides free broadband (although it charges £7.50 for its 'broadband unlimited' service with a larger download allowance) to Sky on-net subscribers with Sky line rental. As part of this offer, Sky also provides free telephone calls to UK landlines at evenings and weekends to customers with Sky line rental. Sky does not have a monthly charge for Sky+ box but charges extra £10 for HD channels.
†Virgin Media excludes broadband. Virgin Media charges an extra £7 for Sky HD channels but has no charge for other HD channels.
‡Prices are for the Sky Go monthly ticket. Sky Go offers fewer entertainment and movies linear channels than are broadcast over satellite. However, Sky Go offers the most popular channels which are available as part of the Entertainment Extra and Dual Movies packs and offers on-demand access to most of Sky's movies: hence we have shown Sky Go prices in the 'maximum basic channels' and 'dual movies' rows of the table.
§Sky's prices with minimum basic channels are based on the Entertainment pack; Virgin Media's prices with minimum basic channels are based on the M+ TV bundle.
¶Not a Sky Movies package: included for comparison. All the package prices shown for Virgin Media include the cost (£5/month) for a TiVo box.
#From September 2011, single movies and sports packages were not available to new subscribers from Sky's call centre but continued to be available from Sky's website.
~Sky's prices with minimum basic channels assume the Entertainment Extra pack and Virgin Media's prices with minimum basic channels assume the XL TV bundle (which includes ESPN).
★Price charged by Sky for a Single Movies package on the TalkTalk platform (this is not the same as the Single Movies package offered on Sky's satellite-distributed service or on Sky Go). Since October 2011, TalkTalk TV was not available to new customers.

2.100 In the context of packages including Sky Movies, we noted two important aspects of bundling:

(a) Sky Movies products are made available as part of packages with basic channels, which often also include other products and services (eg a PVR and sometimes broadband and telephony).

(b) Most Sky Movies products combine Sky Movies with Sky Sports, and these 'combined' products have an incremental price below the total incremental price of their constituent sports and movies products. Hence, we could not just regard the price of the combined products as the sum of their constituents.[53]

- *Virgin Media*

2.101 Virgin Media does not compile its own movie channels, but retails Sky Movies (both the linear channel and associated SVOD content (see paragraph 2.94)). Virgin Media also retails both of Sky's single sports and dual sports packs.

- *TalkTalk*

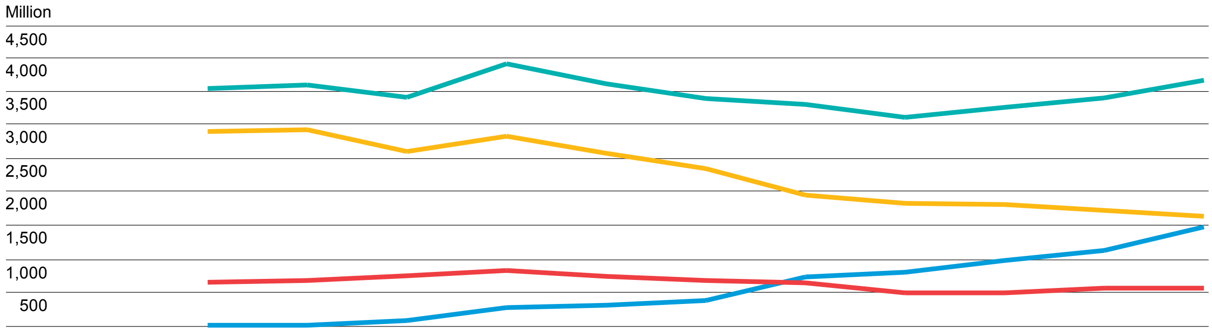
2.102 Sky retails five of its Sky Movies channels on TalkTalk's IPTV platform (see paragraph 2.95). However, [✂]. At present, TalkTalk does not provide any other linear movie services. However, following its relaunch, which is anticipated later in 2012, TalkTalk intends to provide a more comprehensive Sky Movies service, [✂].

The movie audience on linear channels

2.103 The growth in the number of linear broadcasts of movie content has not increased the size of the audience (ie viewings) for movies on linear channels, which is roughly the same size as it was in 2000, as shown in Figure 2.5.

FIGURE 2.5

Total audience for movies on TV (except NVOD), 2000 to 2010



	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Terrestrial	2,901	2,929	2,601	2,833	2,579	2,350	1,949	1,827	1,808	1,725	1,633
Subscription film channels	647	673	741	820	734	671	634	490	489	559	558
Other digital multi-channel	0	0	75	268	305	374	722	796	969	1,118	1,477
Total (million)	3,548	3,602	3,417	3,921	3,618	3,395	3,305	3,113	3,266	3,402	3,668

Source: British Film Institute Statistical Yearbook 2011.
Notes:
1. 'Terrestrial' refers to the five PSB channels by whichever means they are broadcast.
2. NVOD is where the same content is broadcast on a number of different linear channels at staggered start times.

2.104 However, there has been a significant shift in movie audience shares. Since 2000, the number of viewings of movies on the five PSB channels has fallen by over 40 per cent, while the number of movie viewings on subscription pay-TV movie channels[54]

[53] For example, on the Sky platform in October 2011, the incremental price of the combined dual movies and dual sports product was £28 but the total incremental price of the dual movies and dual sports products was £36 (£16 for dual movies plus £20 for dual sports).
[54] We understood this description to refer to the movie channels available on Sky Movies, including Disney Cinemagic.

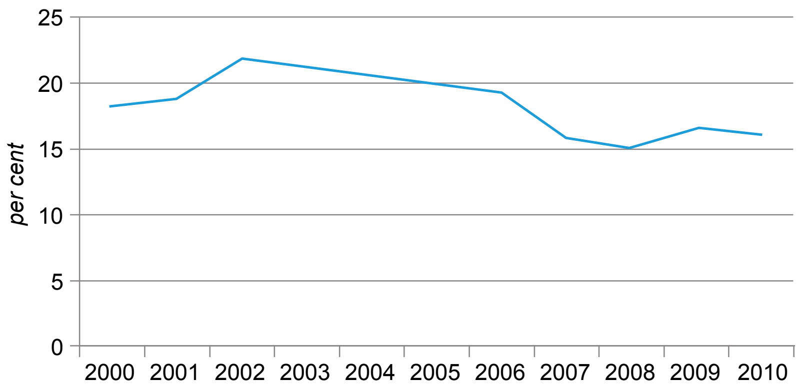
has fallen by about 14 per cent. Movie viewings on ‘other digital multi-channels’ (ie channels other than the five PSB channels (eg BBC 4, ITV 3, FilmFour, etc) and subscription pay-TV movie channels) have, on the other hand, grown and are now well over double those on subscription pay-TV movie channels. There were almost as many movie viewings on ‘other digital multi-channels’ in 2010 as there were on the five PSB channels.

2.105 As movies are released through a series of windows, the most recent movies shown on FTA TV channels will generally be older than the most recent movies shown on subscription pay-TV movie channels. However, the number of movie viewings on subscription pay-TV movie channels has declined from over 800 million in 2003 to just over 550 million in 2010 (see Figure 2.5), to be responsible for less than 16 per cent of the total number of movie viewings on linear TV.[55]

2.106 The trend in the share of the total TV movie audience attributable to subscription pay-TV movie channels is shown in Figure 2.6.

FIGURE 2.6

Pay-TV movie channel share of total TV movie audience



Source: UK Film Council Statistical Yearbook 2010 and CC analysis.

2.107 Although at the time of our report the viewing of Sky Movies still represented a significant proportion of total movie viewing on TV, it represented a much smaller proportion of overall TV viewing. In 2001, Sky Movies[56] was responsible for 2.1 per cent of all TV viewing (by individual) in the UK, but in the 12 months to May 2012 this had fallen to 1.2 per cent. For individuals in households with pay TV, in 2001 Sky Movies was responsible for 4.6 per cent of all TV viewing, but in the 12 months to May 2012 this had fallen to 1.9 per cent.

Home video

2.108 Between 2004 and 2010, the nominal value of the home video sector overall (retail and rental) declined by about 25 per cent.[57] Nonetheless, in 2009, home video still accounted for roughly [✂] of the major studios’ UK distribution revenue (see Figure 2.3).

[55] *British Film Institute Statistical Yearbook 2011.*
[56] Not including viewing of Disney Cinemagic.
[57] *BVA Yearbook*, 2010, p28.

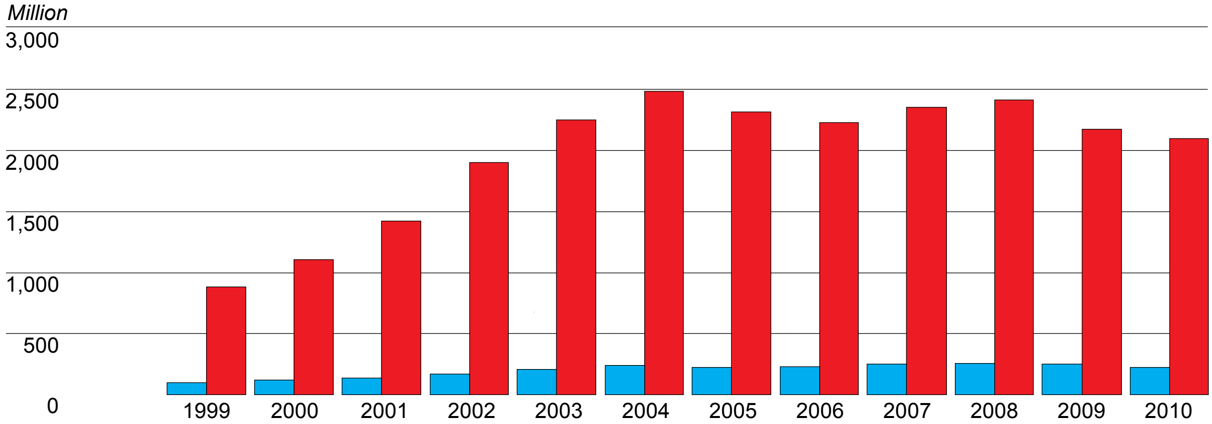
2.109 The volume of home video rentals has been in decline for some years and the volume of home video sales has also declined in the last couple of years. At the same time, the demand for TVOD and EST services has grown. (We discuss the supply of movie content by VOD services and EST in paragraphs 2.114 to 2.146.)

Retail sales

2.110 Following steady growth between 1999 and 2004, the value (in nominal terms) of home video movie retail sales levelled off in 2005 and has been relatively stable since, though there has been a slight decline more recently,[58] as shown in Figure 2.7.

FIGURE 2.7

Film on video retail sales, 1999 to 2010



	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Volume (m)	96	114	135	169	208	234	222	228	249	257	243	223
Value (£m)	878	1,101	1,417	1,896	2,245	2,478	2,309	2,219	2,349	2,408	2,164	2,089

Source: British Film Institute Statistical Yearbook 2011.

2.111 The main retailers responsible for home video sales are the specialist music and video retailers (eg HMV), supermarkets and Internet retailers, particularly Amazon.[59] The supermarkets are the fastest-growing retail channel. Sales by 'generalist' retailers fell in 2009 with the demise of Woolworths. Since 2005 the average unit value of home video sales has fallen by around 15 per cent.

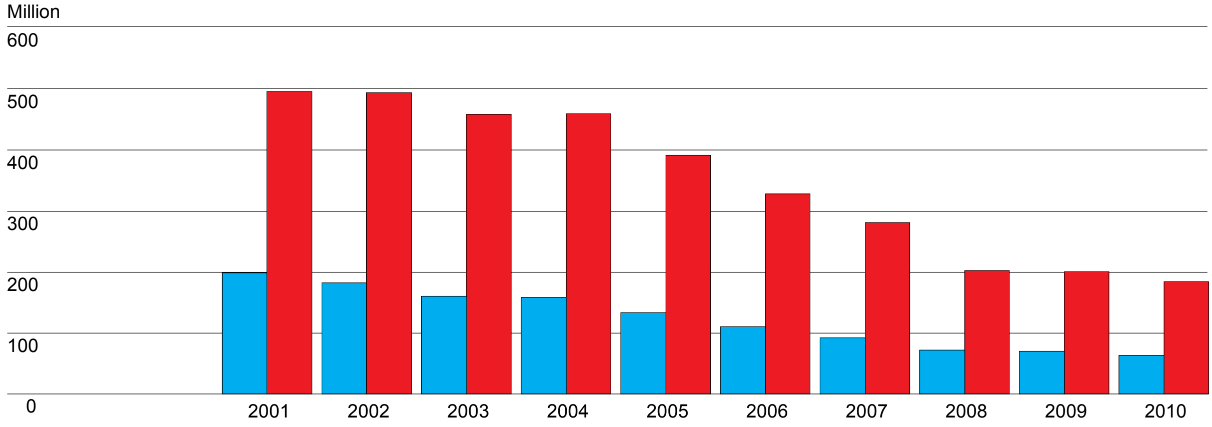
Rental

2.112 The home video movie rental sector is considerably smaller than the retail sector and has been in decline in both volume and value terms for the last ten years, as shown in Figure 2.8.

[58] Particularly if inflation is taken into account.
[59] *BVA Yearbook,* 2010, p42.

FIGURE 2.8

Film on video rental market, 2001 to 2010



	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Transactions (m)	198	182	160	158	133	110	92	72	70	63
Value (£m)	494	492	457	458	390	327	280	202	200	183

Source: British Film Institute Statistical Yearbook 2011.

2.113 Within the home video rental sector, mail-based subscription services (as offered, for example, by LOVEFiLM and Tesco)[60] have been increasing in popularity, to the extent that, by 2010, they were equivalent in value to over-the-counter (non-subscription/single-sale) services.[61] Mail-based services are typically paid for through a flat-rate, monthly subscription which entitles customers to multiple rentals, with titles being requested in order of preference and the supplier endeavouring to satisfy these requirements depending on stock availability. Such services may be offered on an uncapped basis or a limit may be imposed on the number of movies which can be selected at any one time.

VOD movie services

2.114 In this section, we provide first an overview of TVOD and SVOD movie services. Then we describe the TVOD and SVOD services offered by the principal traditional pay-TV retailers (Sky, Virgin Media and BT) to the extent not already covered above, before describing the TVOD and SVOD movie services distributed over the Internet by other providers.

2.115 VOD services enable viewers to watch a range of TV programmes or movies whenever they choose, without being restricted by a linear schedule (see paragraph 2.3). For example, the BBC iPlayer is a free 'catch-up' VOD service, which enables consumers to watch TV programmes and movies which have been recently broadcast on one of the BBC's linear channels (and some programmes and movies from other channels).

2.116 There are two types of pay-TV VOD service: SVOD and TVOD. SVOD services enable customers to watch a selection of programmes or movies for a regularly charged fee; TVOD services enable customers to watch a specific programme or movie in exchange for a one-off fee. In the case of TVOD, the customer is entitled either to download and retain a copy of the programme or movie (known as DTR) or

[60] www.lovefilm.com/, www.tescodvdrental.com/.
[61] *BVA Yearbook*, 2010, p81.

to stream the programme or movie. In both cases, the customer's access to the programme or movie is typically time limited, eg to 48 hours (which is not the case for SVOD where a consumer can view a specific programme or movie as many times as wanted while it remains available on the service).

2.117 VOD movie services confer some of the same consumer benefits as home video, enabling consumers to view content of their choice when they wish, though VOD services provide the added benefit that the content can be watched immediately, without a disc being bought, mailed or collected. The range of titles available on a VOD service at any point in time (TVOD or SVOD) is narrower than the range of titles available on DVD.

2.118 The 'windowing' structure of movie distribution is shown in Figure 2.2 and described in paragraphs 2.69 to 2.72. Movies from the major studios normally become available on TVOD services at the same time as, or shortly after, their release on home video and remain available on TVOD services for about four months in the period prior to the FSPTW. Most movies become available on TVOD services again at some point subsequently, usually after the FTA window when the movie is considered to enter a 'library'. [✂], movie titles are not usually available on TVOD services during the FSPTW due to 'hold-back' provisions. Movies are also generally restricted from being available on TVOD services for a short period prior to the FSPTW (commonly referred to as 'blackout' provisions).[62] In contrast, physical home video discs of a movie will be available to rent continuously from the date of the disc's first release.[63] However, the restrictions with regard to the availability of movies on TVOD services may have a limited impact as, currently, the majority of TVOD sales of a movie occur soon after the movie becomes available on a TVOD basis.[64]

2.119 By definition, movies are not made available on an SVOD basis prior to the FSPTW. To date, SVOD rights have almost always been licensed by the studios in conjunction with the relevant linear rights and not separately. For example, Sky has licensed on an exclusive basis the rights to exhibit in the FSPTW the movies of all the major studios, and some other studios, on both a linear and SVOD basis.[65] Where SVOD rights are licensed separately (eg to a service which does not offer linear channels), this is usually accompanied by a 'holdback' from distribution on a linear basis in the same window.

VOD movie services offered by the largest traditional pay-TV retailers

2.120 We now describe the VOD movie services of the three largest traditional pay-TV retailers: Sky, Virgin Media and BT Vision.

- *Sky*

2.121 Sky offers a PPV[66] service branded Sky Box Office (SBO). Figure 2.9 shows that, for the period 2004 to 2010, [✂] in the total number of movie viewings via SBO, [✂]. In 2011, SBO achieved approximately [✂] per Sky subscriber per year.

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[62] [✂]
[63] In the UK, TVOD service providers are generally granted non-exclusive rights to movie content whereas providers of services with FSPTW content usually acquire rights to this content on an exclusive basis.
[64] Based on evidence we gathered from the major studios.
[65] Subsequent to the FSPTW, some studios license their movies for SVOD distribution in an SSPTW, TSPTW and/or in a library window.
[66] We use PPV to refer to movies available to view on demand and charged for singly but which, unlike TVOD, may only be viewed according to the transmission schedule of the service provider (see footnote to paragraph 2.69).

FIGURE 2.9

SBO views, 2004 to 2010

[✄]

Source: Sky, CC analysis.

2.122 Sky Anytime is an SVOD service provided at no incremental charge to subscribers with a Sky+ or Sky+ HD STB. This is a 'push' VOD service, ie movies are downloaded to and stored on the subscriber's STB hard drive, with typically around five to ten movie titles available to view at any one time.

2.123 Sky Anytime+, launched in October 2010, is an SVOD service made available at no incremental charge to subscribers with a Sky+ HD STB. This is a 'pull' VOD service, ie users can select content from a catalogue for immediate download or streaming. Until March 2012, customers also needed to subscribe to Sky broadband in order to gain access to Sky Anytime+ but, from March 2012, Sky has made its Anytime+ service ISP agnostic, meaning that its pay-TV customers with the appropriate hardware and a broadband connection (from any provider) can access the service. Customers of Sky who subscribe to Sky Movies (with the appropriate STB) may view movies via Sky Anytime+, with over 600 movies available at any time.

2.124 Sky's SVOD services are not available to consumers without linear channels. Therefore, subscribers to Sky Movies receive access to content on both the linear channels and (where possible with the appropriate STB and broadband connection) on an SVOD basis. This applies to subscribers to Sky Movies on Sky's satellite platform, on Sky Go and on Now TV, as well as subscribers to Sky Movies on Virgin Media.

2.125 In January 2012, Sky rebranded its TVOD service within Anytime+ as 'Sky Store'. Sky Store is also available via Sky Go and Now TV.

- *Virgin Media*

2.126 Virgin Media's TVOD movie service is provided by FilmFlex and includes content from all the major studios. Demand for this service grew significantly between 2005 and 2007, [✄] in 2008 and [✄] between 2008 and 2010, as shown in Figure 2.10 ([✄] during 2011). In 2011, usage of FilmFlex on Virgin Media averaged around [✄] movie purchases per active user per month. Virgin Media also offers a Bollywood TVOD service.

FIGURE 2.10

Non-library views on Virgin Media's FilmFlex, 2005 to 2010

[✄]

Source: Virgin Media, CC analysis.

2.127 Virgin Media also offers the PictureBox SVOD service. This service is made up of content which is almost entirely from the SSPTW and subsequent windows, mainly from Universal.

2.128 Virgin Media retails Sky Movies in both SD and HD. The SD service is available to subscribers to all of Virgin Media's packages for an incremental charge. However, in order to access Sky Movies in HD, Virgin Media subscribers must, in addition, purchase the Sky Movies HD ‘bolt-on’ and have a VHD, V+HD or TiVO STB. In 2010, Virgin Media obtained from Sky the right to provide a Sky Movies SVOD service to subscribers to the dual movies package on a bonus basis, which it launched in late 2011.

2.129 Virgin Media told us that [✂].[67]

- *BT Vision*

2.130 BT’s Vision Film is an SVOD service which incorporates the services of PictureBox and Warner Films and offers a combination of SSPTW and library movies from both major and non-major studios.[68] BT’s Vision Film is available as part of BT’s Unlimited TV pack which includes VOD access to TV shows and the ESPN sports channel.[69] BT told us that consumers could also subscribe to Vision Film on a stand-alone basis (ie without subscribing to a basic package of content) [✂]. BT said that Vision Film offered around 600 different movies over a 12-month period, with about 250 titles available through the course of a month and about 150 available at any point in time. As at 31 May 2012, Vision Film had [✂] subscribers.

2.131 BT Vision also offers a TVOD service, branded Box Office.

2.132 BT told us that it was currently in discussions with Sky about [✂].

2.133 BT also told us that [✂].[70]

Other VOD movie services provided OTT

2.134 In addition to the traditional pay-TV providers, there are a number of movie service providers which distribute content over the open Internet (ie OTT) on a TVOD or SVOD basis. In recent years, there have been many material developments in both the number and extent of these services. Internet-distributed VOD services are now offered by many different types of supplier, including retailers (eg Netflix, LOVEFiLM, Apple (iTunes),[71] Blinkbox,[72] Blockbuster, HMV,[73] Dixons (branded KnowHow) and YouTube (Google), device manufacturers (eg Zune and Qriocity),[74] and broadcasters (eg Channel 4 and Film4[75]). and there are many advertising-funded sites.[76] Most of these services offer content on a TVOD basis. The only OTT services offering content on an SVOD-only basis (ie with no linear content) are those of LOVEFiLM and Netflix.

[67] We understood [✂].
[68] Historically, BT’s Vision Film (previously Film Club) carried a few FSPTW movies, for example from Studiocanal via PictureBox (though at the time of our August 2011 provisional findings no Studiocanal movies were scheduled for exhibition on Vision Film and hence no FSPTW movies were shown on Vision Film). PictureBox’s licence agreement with Studiocanal expired in [✂]. BT also told us that, in April 2012, it had the rights to exhibit [✂] movies in the FSPTW from Sony Pictures (though [✂] of these movies did not have a theatrical release).
[69] New subscriptions to the TV Unlimited pack are available to BT broadband subscribers at a cost of £12.50 per month with a 12-month contract and typically require payment of a £40 activation fee.
[70] See footnote to paragraph 2.129.
[71] The majority of Apple’s sales are on an EST rather than TVOD basis.
[72] Blinkbox was acquired by Tesco in April 2011.
[73] The HMV service is provided by FilmFlex which also provides Virgin Media’s TVOD service.
[74] TVOD is available on the Xbox via the Zune marketplace and on the PS3 via the Qriocity ‘store’.
[75] The Film4od service is provided by FilmFlex which also provides Virgin Media’s TVOD service.
[76] We have excluded consideration of the downloading of movies from Internet sites offering video content unauthorized by the rights holder. While we are aware that unauthorized file sharing of video and audio content may be common, no reliable usage data is available.

- *LOVEFiLM and Netflix*

2.135 In December 2011 and January 2012 respectively, LOVEFiLM and Netflix launched stand-alone OTT subscription services offering streamed movies and previously-broadcast TV programmes at prices of £4.99 and £5.99 per month respectively. In LOVEFiLM's case, this was an additional product to its existing subscription products, which offered movies streamed over the Internet bundled with physical DVD rental by post.[77]

2.136 In 2011 and the first half of 2012, LOVEFiLM secured a number of content rights which improved significantly the content available on its streaming service[78] and, in November 2011, LOVEFiLM implemented some pricing and packaging changes to increase the value of those of its products which incorporated this service.[79] Gradually, LOVEFiLM has also enabled its Internet-streaming service to be accessed on new devices, allowing customers to access this service more easily.[80]

2.137 The services of LOVEFiLM and Netflix can be viewed on Internet-connected TVs or on TVs via an Internet-connected STB, games console or other device (eg a Blu-ray disc player or a laptop). They can also be accessed directly on computers or on Internet-connected mobile devices (ie smartphones and tablets) with the appropriate application.

2.138 LOVEFiLM told us that [✂] and that [✂].[81] Netflix told us [✂].

2.139 The movie content offered by Netflix and LOVEFiLM on their streaming services includes FSPTW content from non-major studios and a wide range of content in the SSPTW and subsequent pay-TV windows from both major and non-major studios, as well as TV content. The extent of FSPTW content on these services will gradually increase as movies become available under existing contracts.[82]

2.140 Both Netflix and LOVEFiLM have acquired FSPTW content (and some SSPTW content) on an exclusive basis, [✂].

2.141 Neither LOVEFiLM nor Netflix require an initial contractual commitment from their customers[83] and both offer 30-day free trials to prospective users of their stand-alone SVOD services (alongside other occasional offers).[84] LOVEFiLM makes the same free trial offer in relation to its hybrid SVOD/DVD services.

2.142 At the end of November 2011, LOVEFiLM had around [✂] million paying subscribers in the UK but, by the end of May 2012, this had increased to about [✂] million, of

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[77] See Appendix 4.1, paragraphs 23–28, for a discussion of DVD rental.
[78] This content was acquired almost entirely after the publication of our August 2011 provisional findings.
[79] In particular, LOVEFiLM increased by one the entitlement to the number of discs that could be taken out at any one time on its unlimited package: for example, on its £9.99 plan, it increased the number of discs that could be taken out at a time from one to two (previously the two-disc service had cost £12.99). At the same time as launching its streaming-only package, LOVEFiLM reintroduced an unlimited hybrid plan with one disc at a time for £7.99 per month, which had previously cost £9.99 (in May 2011). We observed that the launch of the new stand-alone SVOD product by LOVEFiLM was part of a general focus on promoting the use of its Internet-streaming service (rebranded LOVEFiLM Instant).
[80] In our view, the [✂], whether on a hybrid product or a stand-alone SVOD product, meant that LOVEFiLM's OTT services had become much more relevant to pay-TV retail competition than at the time of our August 2011 provisional findings or previously. In light of these significant developments, and for simplicity, we refer to the OTT service of LOVEFiLM as having launched in December 2011 (when the stand-alone OTT product became available).
[81] See footnote to paragraph 2.129.
[82] Netflix told us that it would have [✂] per cent more movies on its service at 31 July 2012 than it had on its service at 31 January 2012 (see Appendix 4.12).
[83] This is in contrast to traditional pay TV where retailers typically require initial contracts lasting 12 to 18 months in order to recover up-front costs associated with installation costs and subsidizing an STB.
[84] Customers must sign a cancellable bank or credit card mandate to enable payments to start at the end of the free trial period (unless cancelled before then).

which almost [✂] were customers of its unlimited streaming service. This figure included [✂] paying subscribers to LOVEFiLM's streaming-only service.

2.143 In April 2012 Netflix stated publicly that its UK launch had achieved the highest net additions it had ever seen in the first 90 days of an international market launch.[85] By the end of May 2012, less than five months after launch, Netflix had [✂] paying subscribers in the UK and a further [✂] triallists (of which around [✂] per cent on the basis of its experience to date might be expected to become paying subscribers).[86] Further details on the growth in subscriber numbers of both Netflix and LOVEFiLM and their forecasts for the future are provided in Appendix 4.2.

2.144 LOVEFiLM estimated that its average subscriber acquisition cost (SAC) for 2011 across all of its packages was £[✂].[87] Netflix estimated its [✂]. Netflix estimated that it would have an SAC of [✂].[88] Netflix told us that its SAC [✂]. We noted that [✂] Netflix used Facebook as the channel through which consumers were encouraged to subscribe to its service in the UK. More generally, we noted that SACs for OTT pay-TV retailers were likely to be substantially lower than for traditional pay-TV retailers because they do not provide proprietary STBs to their customers, whereas traditional pay-TV retailers do, usually funded by a subsidy which represents a [✂] part of their SACs.

EST movie services

2.145 EST, otherwise known as download-to-own (DTO), enables consumers to buy digital content to download and retain permanently. The largest provider of movies by EST is Apple, through its iTunes store. Apple told us that, [✂]. Apple told us that [✂].

2.146 Data from the studios indicated that revenues from EST sales had grown significantly in recent years and was forecast to continue growing, though from a small base (see Appendix 2.2). Disney told us that its EST revenues had risen exponentially during the last five years, but from a low base and so remained modest. Warner provided us with data showing [✂]. Fox forecast that its EST revenues would [✂]. Paramount told us that, while its Internet-distributed sales (DTR and DTO) had increased, this [✂]. We noted that average studio TVOD revenue in 2010 was roughly [✂] times that of EST.

Distribution and accessibility of OTT services

2.147 In this subsection, we discuss in more detail the distribution and accessibility of OTT services, and the impact of technological developments.

2.148 OTT services can be accessed using a computer or other fixed or mobile Internet-connected device either via the device's browser or via an application provided by the OTT service operator and installed on the device concerned (see next paragraph). The quality of the sound and pictures available on an OTT service will depend on a number of factors, including the broadband speed available to the consumer,[89] whether others are using the Internet connection at the same time and,

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[85] http://files.shareholder.com/downloads/NFLX/1818201195x0x562104/9ebb887b-6b9b-4c86-aeff-107c1fb85ca5/Investor%20Letter%20Q1%202012.pdf.
[86] See Appendix 4.2.
[87] LOVEFiLM forecast that its average SAC would [✂] in 2012 and [✂] in 2013.
[88] Netflix [✂].
[89] LOVEFiLM told us that its minimum recommended speed was 2 Mbits/s, though Netflix on its website states that its minimum recommended speed is 0.5 Mbits/s. Ofcom's November 2011 Infrastructure Report stated that 86 per cent of households with broadband Internet connections could receive a 2 Mbits/s fixed Internet connection (and coverage of superfast broadband was

possibly, whether others are using the same local communications infrastructure. However, LOVEFiLM told us that, in general, bandwidth was a significant issue for only a small number of its customers. LOVEFiLM estimated that around 80 per cent of its users had the required speed at peak time (Sunday nights 8pm to 10pm), and this percentage would be higher at other times.[90]

2.149 The environment in which content can be accessed through most Internet-connected devices is commonly referred to as a 'walled garden'. This refers to the fact that consumers can only access those services which are configured for the device. Content suppliers must therefore negotiate with device manufacturers for their applications to be accessible over devices and must configure their services for each device.[91] For example, Xbox users can access movies through Microsoft's Zune Marketplace (TVOD and EST), Netflix (SVOD), LOVEFiLM (SVOD and TVOD), Blinkbox (TVOD) or Sky (via either Sky Go or Now TV). PS3 users face a similar choice. Movie content may also be accessed over the Internet on many mobile devices (ie smartphones and tablets).

2.150 By contrast with traditional pay TV where the pay-TV platform provider takes responsibility for the delivery of content to the viewer's TV (eg via satellite, cable or a closed IPTV connection), including in almost all cases by providing an STB,[92] an OTT customer will procure the necessary Internet access and the device(s) through which to access the OTT service independently and in most cases, for other purposes, meaning that in most cases there is minimal cost for the consumer in addition to the cost of the service. However, some consumers may have to pay some additional Internet charge if their ISP agreement has too low a broadband usage cap or if their Internet service is charged on a usage basis (for example, with some mobile services).

Device ownership

2.151 Consumer research submitted to us by LOVEFiLM suggested that consumers prefer watching VOD and, in particular, movies by VOD, on a TV, in a more relaxed 'living-room' atmosphere. We also noted that a relatively high proportion of iPlayer TV views were requested by Virgin Media customers, which are viewed on a TV[93] and that nearly half of the views requested on iPlayer are now via a TV set rather than a computer.[94] This evidence indicated that, where consumers can watch VOD content on a TV, a higher proportion do so.

2.152 We noted that games consoles were the most widely-owned device which can facilitate viewing of Internet-distributed content on the TV. Ofcom found that, in 2010,

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58 per cent of premises). Ofcom stated that it expected this to increase over the coming year. In November 2011, the average actual UK fixed-line residential broadband speed was 7.6 Mbits/s, a 22 per cent increase over the average recorded in the previous year (Ofcom UK fixed broadband speeds, November 2011).

90 LOVEFiLM noted that measurement of broadband speeds was complicated due to the large number of variations, including particular service configurations, users' home networking, users' activity, device configuration and ISP capacity.

91 This does not apply in the case of computers, including laptops, where viewing is via a browser. Another exception to the 'walled garden' model for accessing Internet-distributed content is Google TV. Google TV's approach appears to be to offer the consumer access to the full open Internet through the TV, as if using a computer. Where an application from the service provider has to be installed, this application will facilitate access to the service provider's site and ensure that the content accessed is configured appropriately for the device concerned. Some devices may be able to access the service provider's website using the device's browser, but this may provide less satisfactory results.

92 We noted that traditional pay-TV retailers had extended their pay-TV packages to include OTT access as a bonus, for example Sky gives its subscribers OTT access (branded Sky Go) on laptops, PCs, the Xbox 360 games console and some mobile devices (each subscriber can register two Sky Go devices and watch on both at the same time, but only one of these registered devices can be changed every month). Where Sky Anytime+ is delivered via a non-Sky broadband connection, Sky is not responsible for the delivery of the service.

93 The Virgin Media customer base comprises fewer than [✂] million subscribers but accounts for 22 per cent of requests on iPlayer. See http://downloads.bbc.co.uk/mediacentre/iplayer/iplayer-performance-april12.pdf.

94 http://downloads.bbc.co.uk/mediacentre/iplayer/iplayer-performance-april12.pdf.

there were approximately [✂] million connectable[95] Xboxes, [✂] million PS3/PSPs and [✂] million Wii consoles in UK households.[96] According to data collected by Ofcom in early 2012, over half of households have a games console (52 per cent); of households with a TV, 5 per cent have a 'smart TV'; almost half of adults who personally use a mobile phone have a smartphone (43 per cent); 17 per cent of households have a Blu-ray disc player; and 11 per cent have a tablet computer (up from 2 per cent in the prior year).[97]

2.153 In addition, all the pay-TV customers of BT Vision have an Internet-connected STB and Virgin Media's STBs can receive VOD content.[98] Sky also makes available a subsidized IP-connectable STB to its customers in certain circumstances.[99]

Device usage

2.154 As well as considering device ownership, we also considered the extent to which customers were using the 'Internet-connected' functionality of their devices to view audio-visual content.

2.155 In its 2012 Communications Report, Ofcom stated that:

- 37 per cent of individuals in Q1 2012 said they watched catch-up TV distributed over the Internet;[100]
- one-third of individuals with access to a games console said they used it to watch audio-video content;[101] and
- 65 per cent of individuals with a 'smart TV' said they had used it at least once to access the Internet.[102]

2.156 According to data collected by Ofcom in early 2012, 16 per cent of consumers with a games console had used it at least once in the preceding 12 months for watching catch-up TV distributed over the Internet, 14 per cent had used it for browsing the Internet and 10 per cent had used it for watching video clips (eg YouTube).[103] According to the same data, 45 per cent of consumers with a 'smart TV' had used it at least once in the preceding 12 months for watching catch-up TV distributed over

[95] As defined by the manufacturers. Microsoft, for example, defined its connected Xbox 360 users as those with at least its Free (previously 'silver') Xbox Live membership.
[96] Ofcom,Communications Market Report 2011, p110.
[97] This information has been sourced from Ofcom's technology tracking survey for Q1 2012 (http://stakeholders.ofcom.org.uk/binaries/research/statistics/2012apr/Ofcom_Technology_Tracker_Wa1.pdf). We noted that these figures do not reflect the uses to which the relevant devices are put.
[98] Virgin Media told us that most Virgin Media STBs are (theoretically) capable of connecting to the Internet. While TiVo boxes are capable of receiving audiovisual content via the Internet connection and are capable of hosting through-the-middle applications, this is not the case for legacy boxes which do not have the required software to receive or host such content.
[99] An STB subsidized by Sky *(a)* is offered to new customers when they sign up to Sky's pay-TV retail services; *(b)* may be offered to existing subscribers upgrading their pay-TV package; or *(c)* may be offered to existing subscribers when replacing STBs when a problem is detected. Existing subscribers can also acquire an IP-connectable STB from Sky or other retailers without upgrading their pay-TV package, although in such circumstances the STB is not subsidized by Sky. All the STBs Sky currently offers to new customers have an Ethernet port which allows them to be connected to the Internet or to another Sky STB which in turn may be connected to the Internet.
[100] This represented a two percentage point increase from Q1 2011 and a six percentage point increase since Q1 2010.
[101] Ofcom, Communications Market Report 2012, p177.This includes watching catch-up TV, live TV and video clips but not DVD's/Blu-ray.
[102] Ofcom, Communications Market Report 2012, Figure 2.18, p131. Ofcom defined a 'Smart TV' as a stand-alone TV set with inbuilt Internet functionality, requiring connection to a broadband router.
[103] Ofcom's technology tracking survey for Q1 2012. This data was used by Ofcom in its Communications Market Report 2012 so the data in this paragraph is a breakdown of the data in the previous paragraph.

the Internet, and around 20 per cent had used it at least once in the same period for accessing VOD services (eg YouTube, LOVEFiLM and Netflix).[104]

2.157 BT told us that, while in the UK there were [✂].[105]

2.158 Sky carried out a survey on the extent of Internet connectivity to access TV programmes or movies on TV, which found that, in September 2011, about [✂] per cent of UK households possessed an Internet-enabled TV but, of these households, only about [✂] per cent had used it to access content over the Internet in the previous three months (see Table 2.6). Many more respondents had accessed content over the Internet by connecting a computer or laptop to their TV. In total, about [✂] per cent of households had used an Internet-enabled TV or a TV connected to a computer to access TV programmes or movies on TV and about [✂] per cent of households had used the Wii to access content in this way, with similar figures for the Xbox 360 and the PS3.[106]

TABLE 2.6 **Household connection of TVs to Internet and use of games consoles to access TV programmes or films to view on TV**

per cent of UK households, September 2011

	Ownership	*Ever used to access TV programmes or films on TV*	*Used in last 3 months to access VOD over the Internet*
Computer/laptop connected to TV		[✂]	[✂]
Internet-enabled TV	[✂]	[✂]	[✂]
Either of the above			[✂]
Nintendo Wii games console	[✂]	[✂]	[✂]
Xbox 360 games console*	[✂]	[✂]	[✂]
PlayStation 3 games console	[✂]	[✂]	[✂]
Any of the above (approx)†			[✂]

Source: CC calculations based on market research carried out for Sky. The research was carried out by means of an online survey with a sample size of 3,500.

*Includes those with and without HD.
†Assumes no household used more than one games console to access TV programmes or films in last three months.

2.159 We noted that the Sky data pre-dated the launch in December 2011 and January 2012 respectively of the OTT services of LOVEFiLM and Netflix and the launch in July 2012 of Sky's Now TV service. We also noted that the viewing of Internet-distributed content, through various devices, was experiencing rapid growth. For example, Sky told us that the number of SVOD views on Sky Go had grown by nearly [✂] per cent, from [✂] million views in 2009/10 to [✂] million views in the first 11 months of 2011/12. Similarly, LOVEFiLM told us that the total number of digital views by its UK subscribers for the period June 2011 to October 2011 varied between [✂] million and [✂] million per month but, by February 2012, this had increased to [✂] million per month. Figure 2.11 shows this trend for one particular device, the PS3.[107]

[104] ibid.
[105] BT told us that this information was based on data obtained from *Screen Digest*.
[106] Though, in the case of the Xbox 360 and the PS3, the results included respondents who used their games console to view content by playing a disc rather than accessing it over the Internet.
[107] LOVEFiLM digital views included TVOD and AVOD (advertising VOD) as well as SVOD, but the vast majority were SVOD (in February 2012 [✂] per cent were SVOD, [✂] per cent AVOD and [✂] per cent TVOD).

FIGURE 2.11

LOVEFiLM views on PS3

[✄]

Source: LOVEFiLM.

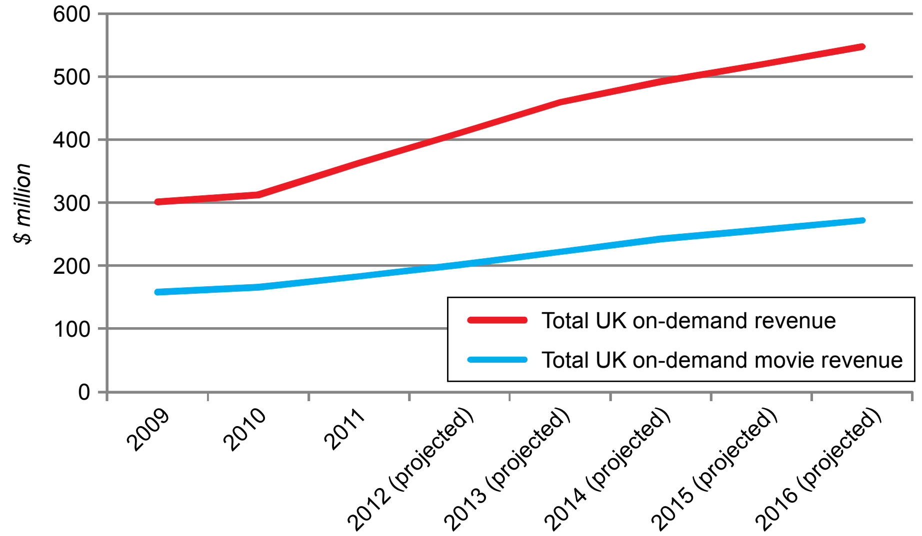
2.160 We also noted that viewings of the BBC iPlayer service (the most popular source of TV content accessed on the Internet) had increased significantly on non-computer devices. In April 2010, 33 per cent of BBC iPlayer viewing was via a device other than a computer but, by April 2012, this had increased to 43 per cent (see paragraph 2.3).[108] In April 2012, 15 per cent of iPlayer requests came from mobile devices (smartphones and tablets), up from 5 per cent just over a year earlier in January 2011.[109]

Future trends

2.161 It appeared to us that most forecasts of viewing of Internet-distributed TV and movie content predicted continued rapid growth. For example, Universal provided us with forecasts of VOD usage from both *Screen Digest* and *Informa*, as shown in Figures 2.12 and 2.13.

FIGURE 2.12

UK VOD forecasts by service



Source: Screen Digest, June 2012.

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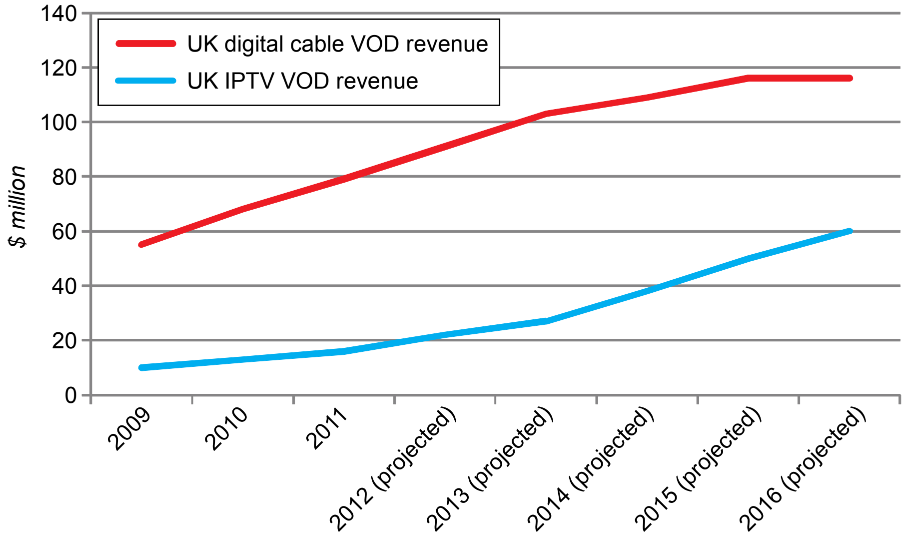
[108] See http://downloads.bbc.co.uk/mediacentre/iplayer/iplayer-performance-april12.pdf.
[109] See http://downloads.bbc.co.uk/mediacentre/iplayer/iplayer-performance-april12.pdf and www.bbc.co.uk/blogs/bbcinternet/bbc_iplayer_performance_jan_2011.pdf.

FIGURE 2.13

UK VOD forecasts by distribution method



Source: *Informa*, December 2011.

2.162 On the basis of the submissions we received, it appeared to us that the continued growth of viewing of content distributed over the Internet would be facilitated by a number of factors, including *(a)* the increasing adoption of Internet-connected TVs and/or STBs (improving convenience and reducing dependence on games consoles as a means of accessing services on households' main TV); *(b)* the increasing availability of broadband, and faster broadband; *(c)* an increasing awareness of OTT services among less technologically-aware households, in particular following the launch of services which 'popularize' such services, eg YouView; and *(d)* social factors, including interaction on social media.

2.163 Some parties provided us with estimates and projections in relation to these factors. For example, Sky provided us with data from a 2012 report by Futuresource Consulting which estimated that the installed base of Internet-connected TVs would grow to 27 million by 2016. Paramount noted a forecast by the BBC that almost 36 million Internet-enabled TVs would be installed in UK homes by the end of 2016. Paramount also noted that BT had committed to making fibre-based superfast broadband available to 40 per cent of UK households by summer 2012 and to 67 per cent of households by 2015.[110]

2.164 We noted that many press commentators expected YouView, which 'soft-launched' in July 2012,[111] to increase significantly consumer usage of OTT services. Through an Internet-connected STB, YouView will enable consumers to access free catch-up VOD services, such as the BBC iPlayer, and paid-for VOD services, including movies, on their TVs (as well as linear services by DTT). BT told us that YouView would provide another, and potentially very important, means of viewing Internet-distributed VOD services on TV. YouView told us that it expected to achieve an installed base of [✂] million households by 2014.

[110] BT's estimates suggested that fibre broadband would be available to two-thirds of premises by 2014 (though it anticipated extending its ADSL2+ broadband capability to 90 per cent of premises by spring 2013).
[111] See footnote to paragraph 2.11.

2.165 LOVEFiLM told us that it believed there was unmet demand for movies distributed over the Internet, akin to the unmet demand which had existed for a period for HDTV. It said that, once consumers could access its digital content on TV, the growth in the viewings of this content distributed over the Internet would accelerate. By the end of 2014, LOVEFiLM forecast that it would have [✄] million UK subscribers to its service (both physical discs and Internet-distributed content), the equivalent of around [✄] per cent of UK households (see Appendix 4.2). Blinkbox told us that it expected continued growth in the take-up of Internet-connected devices and the consumption of VOD content through these devices. It forecast that, by 2015/16, 80 per cent of VOD viewings would be on TV, with the growth driven in particular by the sale of smart STBs and the launch of YouView.[112]

2.166 We also considered whether the adoption of technology in other sectors could be informative about the likely rate of adoption of technology which would enable consumers to view VOD content distributed over the Internet on a TV. In particular, we considered the experience of Freeview and the growth of Internet-distributed recorded music. This analysis is set out in Appendix 2.3 and summarized below:

(a) Freeview took over three years from launch in 2002 to achieve 20 per cent penetration of UK households (ie around 5 million households), though its adoption increased substantially after that. While the prospect of digital switchover facilitated its growth (and such a deadline does not exist to encourage the take-up of OTT services, or platforms which enable such services (eg YouView)), we noted that other factors (such as its limited promotion by some of the PSBs) were likely to explain Freeview's relatively slow progress in its early years. Further, compared with 2002, consumers now upgrade their TV sets more frequently which may enable new services, such as YouView, to achieve a faster rate of growth.[113]

(b) The rate of adoption of digital recorded music suggested that a switch to this mode of delivery for TV and movie content could take some time to become established. However, switching in the early years of digitally-distributed recorded music was likely to have been inhibited by the low rate of broadband penetration at that time, which has increased substantially since.

2.167 We also considered how movie services in the UK might develop in the future by reviewing briefly how consumers access movie content (and in particular FSPTW content) on pay TV currently in the USA where stand-alone SVOD services have been available for longer than in the UK. This analysis is set out in Appendix 2.4 and summarized below:

(a) We noted that the US market is unlike the UK market in that the exclusive rights to the major studios' FSPTW content are divided between three pay-TV providers (Home Box Office (HBO), Starz and EPIX). We also noted that Netflix, originally a subscription-based DVD rental by post business, offers an OTT SVOD service with FSPTW movies from Paramount and several non-major studios.[114,115]

(b) At the time of our August 2011 provisional findings, we could identify no other examples, either in the USA or elsewhere, of an Internet-distributed SVOD service (not packaged with a linear service) which offered the FSPTW movie content of one or more of the major studios. However, by the time of this report, two

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[112] Blinkbox made this submission to us prior to being acquired by Tesco.
[113] Ofcom Communications Market Report 2010, p113, and http://stakeholders.ofcom.org.uk/binaries/broadcast/reviews-investigations/psb-review/psb2010/overview1.pdf.
[114] [✄]
[115] Until February 2012, Netflix's service in the USA also offered FSPTW content from Starz, which included content from Sony Pictures and Disney, though the FSPTW content of Sony Pictures ceased being available on the service in mid-2011.

examples had emerged: (i) in Canada, Netflix now offers the FSPTW content of Paramount and Fox; and (ii) in Germany, LOVEFiLM now offers the FSPTW content of Paramount. Furthermore, the major studios told us of many current negotiations in different European territories where one or more of the bidders was seeking SVOD-only rights to FSPTW content, often on an exclusive basis.[116]

Summary of the provision and consumption of movie services on TV

2.168 The way in which consumers watch movie content is changing in the light of technological and market developments. For example, the number of home video rentals is less than a third of what it was ten years ago and, on TV, consumers have increasingly been watching movies on digital multi-channels, at the expense of watching them on PSB channels or subscription pay-TV channels (including Sky Movies). This is despite the fact that movies shown on the digital multi-channels (and other FTA channels) will generally be older than the most recent movies shown on Sky Movies. As a result, between 2003 and 2010 the number of movie viewings on pay-TV channels declined by more than 30 per cent, from over 800 million to just over 550 million.

2.169 Although most movies continue to be watched on linear TV channels,[117] VOD usage is increasing rapidly. In particular, consumers are now able to watch movies streamed or downloaded from the Internet through many different services using a broadband Internet connection and a suitable Internet-connected device. The ownership of such devices, which includes STBs, games consoles and Internet-connected TVs, is large and increasing, and around 76 per cent of households now have a broadband Internet connection. The number of movies viewed on demand over the Internet has also been growing significantly.

2.170 It appeared to us that all of the traditional pay-TV platforms were seeking to enhance the VOD movie offerings available on their platforms and we noted that YouView would soon offer consumers on-demand services. In our view, these developments, and the proliferation of TVOD and SVOD services available to consumers more generally, were indicative that VOD usage was likely to continue to increase.

[116] That is, in most cases the content would not be available at the same time on a competing SVOD and/or linear service.
[117] Though subscription pay-TV channels account for only around one in six movie viewings on TV linear channels (see Figure 2.6).

3. Theory of harm

3.1. In this section we set out the theory of harm which we used to structure our analysis. We also describe how our views with respect to this theory and its application developed through the course of our investigation taking account in particular of market developments.

Context for the theory of harm

3.2. The terms of reference covered both the supply and acquisition of major studios' FSPTW movie rights and the wholesale supply and acquisition of packages which include Sky Movies (see paragraph 1.1). Following the reference, we sought views on the approach we should take to our investigation and the key issues we should consider.

3.3. Virgin Media, BT and other retailers of pay TV made submissions to Ofcom, which they repeated to us, that they faced a 'vicious circle' whereby Sky could continuously reinforce its market power due to its vertical integration and its ability to aggregate key content rights, whilst also creating high barriers to entry and expansion. These parties told us that these factors conferred on Sky considerable advantages in winning key premium movie rights. They said that Sky's control of movie content in the FSPTW restricted competition between pay-TV retailers and led to higher prices and less choice for consumers.

3.4. BT told us that Sky's refusal to supply key premium channels to its competitors prevented them from competing effectively to gain customers at the retail level, while Sky was able to use its ownership of these channels to drive the growth of its own subscriber base. BT said that its lack of scale relative to Sky at the retail level prevented it from competing effectively with Sky in the bidding process for rights to premium movie content, thereby allowing Sky to maintain its exclusive ownership of these rights. BT added that Sky had both the incentive and the ability to ensure that effective wholesale and retail competitors of packages containing channels showing recent movies from the six major studios in the FSPTW in the UK did not emerge, allowing Sky to sustain its position of market power in these markets.

3.5. Ofcom also expressed a concern that, as a result of Sky's position with respect to both linear and SVOD FSPTW rights, the development of premium movie SVOD services might be constrained. It said that, in the short term, Sky might have a limited incentive to exploit its SVOD rights and, in the longer term, as it developed its own SVOD services, Sky's market power in relation to its linear channels could be transferred across to these new services.

Theory of harm

3.6. On the basis of the reference and the initial submissions we received, we articulated the concern to be investigated in terms of a hypothesis as follows:

> The control by Sky of the acquisition and distribution of movie content on pay TV during the FSPTW, as a result of its market power in the pay-TV retail market, adversely affects competition between pay-TV retailers. This adverse effect on competition in the pay-TV retail market results in effects both on consumers and/or on the suppliers of pay-TV movie rights for the FSPTW (with possible consequential effects on competition between the suppliers of pay-TV movie rights for the FSPTW).

3.7. As we progressed our analysis we continued to review this theory of harm to ensure that it articulated properly and fully the relevant issues for us to investigate. We found that our focus in the theory of harm on the pay-TV retail market as a whole and on the supply and acquisition of FSPTW movie rights from all studios (ie major and non-major studios) was appropriate.

3.8. In our view, this theory of harm also captured the specific concerns expressed by Ofcom with respect to the development of SVOD services (see paragraph 3.5) and, prior to publishing our revised provisional findings in May 2012, we received no comments to suggest otherwise.

3.9. We identified four circumstances which we expected would be present were this hypothesis to be correct, as follows:

(a) Sky has market power as a retailer of pay TV such that there is ineffective competition in the market for pay TV (discussed in Section 5);

(b) pay-TV movie content in the FSPTW is significant to consumers in choosing their pay-TV retailer, which requires, among other things, that movie content on pay TV in the FSPTW has no close substitutes (discussed in Section 6);[1]

(c) other pay-TV retailers (and/or third parties) cannot obtain the rights to sufficient movie content in the FSPTW directly from the studios in order to create movie services which compete effectively with Sky (discussed in Section 7); and

(d) most movie content in the FSPTW on pay TV is controlled by Sky, and there is limited availability to other pay-TV retailers both of movie content in the FSPTW and of Sky's movie products which include this content (discussed in Section 8).

3.10. Accordingly, in order to answer the statutory questions (see paragraphs 1.1 to 1.3), we focused our assessment of competition in the relevant markets around these four areas: *(a)* Sky's position in the retail market; *(b)* the role of FSPTW content (and Sky Movies which has the majority of this content) in consumers' choice of traditional pay-TV retailer;[2] *(c)* barriers to acquiring FSPTW movie content; and *(d)* Sky's wholesale terms of supply of Sky Movies.

3.11. Understanding Sky's position in the retail market was important to inform our approach to the subsequent issues. We then focused on the role of FSPTW content (and Sky Movies) in consumers' choice of traditional pay-TV retailer because our views on this issue determined our approach to and the relevance of the other aspects of our theory of harm. If FSPTW content (and Sky Movies) was not significant to consumers in their choice of traditional pay-TV retailer, it seemed to us implausible that *(a)* barriers to the acquisition of FSPTW rights could on their own be capable of giving rise to an AEC; and *(b)* the terms of Sky's wholesale supply of Sky Movies could cause Sky's rivals to be at such a disadvantage when competing for subscribers in the pay-TV retail market as to harm competition.

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[1] It should be noted that the absence of close substitutes would not mean, by itself, that FSPTW content was significant in this way (see Section 6).
[2] Our concern was with the significance of *Sky's* FSPTW movie content to consumers' choice of *traditional* pay-TV retailer because Sky had the majority of FSPTW content and, from our analysis of part *(a)*, we found that the ineffectiveness of competition in the pay-TV retail market derived from Sky's position in traditional pay-TV retailing.

Market developments

3.12. Subsequent to the publication of our provisional findings in August 2011, there were a number of important market developments, in particular the launch by Netflix in the UK of an SVOD-only OTT pay-TV service offering movie content, and significant enhancements by LOVEFiLM to its OTT service, which became available to consumers on a stand-alone basis (in addition to being available on a bundled basis with its DVD rental by post service).[3] Also, shortly prior to our final report Sky launched its own OTT pay-TV service (Now TV), with Sky Movies as the first product available on this service. While at the time of our August 2011 provisional findings there were some early signs of some of the developments or changes to which we refer in this report, the implications of these developments were far from clear and there were many more developments subsequently.

3.13. In light of these developments, we considered whether the hypothesis set out remained fit for purpose. We noted that [✂], Netflix told us prior to its launch in the UK that regulatory intervention was not required and could distort the market incentives that currently exist.[4]

3.14. In response to our revised provisional findings, BT told us that, in circumstances where we concluded that our original theory of harm was not made out, yet competition in the relevant market we had identified was not effective, we should consider whether any alternative theory of harm might be appropriate in order to analyse the ongoing lack of effective competition we identified. BT submitted that, had we done so, we would have identified a framework which would have led to those competition problems being (partially or wholly) addressed. However, BT did not propose any alternative framework which related to the supply and acquisition of the products referred to us. As noted above, we reviewed whether any alternative framework was needed but decided it was not (see paragraphs 3.7 and 3.8).[5]

3.15. None of the representations we received led us to believe that the theory of harm (set out in paragraph 3.6) should be amended and, in our view, it provided the appropriate framework for our analysis. Nonetheless, when considering the four areas of our analysis (see paragraph 3.10), we took account of the new OTT pay-TV services which emerged during our inquiry, and we considered whether these market developments gave rise to any additional issues. We explain in each section, as appropriate, how the circumstances which we expected to observe if the hypothesis articulated in our theory of harm was correct (see paragraph 3.9) have been revised or modified to take account of market developments, as well as in the light of representations we received.

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[3] Although both Netflix and LOVEFiLM have acquired subscription pay-TV movie rights, including FSPTW rights from non-major studios, they have not currently acquired FSPTW movie rights from the six major studios. However, we did not define a separate market for the FSPTW rights of major studios and included these rights in the same market as the FSPTW rights of other studios (see Section 4). We also recognized that the substitutability between downstream services with different amounts of FSPTW compared with other movie content was likely to be greater than the substitutability between FSPTW rights and other movie rights (see Section 4).

[4] Subsequently, Netflix stated publicly that if it were unable to secure rights to FSPTW content from major studios in the next year or so, this might support a case for market intervention.

[5] In our revised provisional findings we said that competition in the pay-TV retail market was ineffective. In its response, BT suggested that, given this finding that a problem existed, we should have addressed it, even if it required us to seek a variation to our terms of reference. We did not believe this would have been appropriate. Ofcom chose to refer to us the supply and acquisition of specific movies products in a context where it had reached a decision and imposed remedies in relation to other content which would have been highly pertinent to any broader inquiry. Our theory of harm was formulated to enable us to investigate whether there were features of the market(s) in which these referred products were supplied or acquired that gave rise to an AEC. In response both to our working paper on our theory of harm and our provisional findings, no party suggested to us that this theory of harm was not fit for purpose. Addressing the wider causes of Sky's position in the retail market would have required a very different reference, not simply a variation to the reference we received.

Supply of movie rights

3.16. We considered whether there was a separate theory of harm relating to the supply side of the market for FSPTW movie rights. However, there are many movie studios and we found that no studio had a particularly large market share. We also found that market shares were volatile, depending in each period on the commercial success of each studio's creative output (see Appendix 3.1). Therefore, on the supply side, we concluded that this market was not heavily concentrated. Due to this lack of concentration, and because we did not receive any complaints or see any evidence which would indicate that an individual movie studio holds sufficient market power to suggest concerns about its licensing arrangements, we did not investigate a theory of harm relating to the supply of FSPTW movie rights by an individual studio. In addition, because we did not receive any complaints or see any evidence which would indicate concerns about collective action by movie studios, we did not investigate a theory of harm relating to the supply of FSPTW movie rights on the part of studios collectively. On both these points, we received no comments or representations to suggest that we should do otherwise.

4. Market definition

Introduction

4.1 Our guidelines[1] state that, in practice, the analysis of market definition and the assessment of competition will overlap and should not be viewed as two distinct chronological stages. Therefore, although we discuss market definition separately in this section, it should be seen in the context of our overall assessment of competition.

4.2 Our guidelines also state that we do not regard market definition as an end in itself, but rather as a framework within which to analyse the effects of market features; and that it is a useful tool for identifying the competitive constraints present in the market.[2]

4.3 There are two dimensions to the definition of a market: a product and a geographical dimension. In the current case, there was a consensus in the submissions we received that the geographic market is national.[3] We agreed. Therefore, we focus in this section on discussing the product market.

4.4 We assessed all relevant levels of supply, ie the rights level, the wholesale level and the retail level. As the demand for wholesale services and for FSPTW rights is ultimately derived from a demand by consumers for retail services, we considered first the retail level, then the wholesale level, and then the rights level. In paragraphs 4.5 to 4.28 we summarize our assessment of the relevant market definition at each of these three levels before setting out our analysis more fully.

Summary

The retail level

4.5 Until the launch of Sky Movies on Now TV, it was not possible for pay-TV consumers to subscribe to Sky Movies packs or Sky Movies products[4] on a stand-alone basis, ie without also taking a basic pay-TV subscription or package.[5] Furthermore, a high proportion of Sky Movies subscribers take a package including Sky Sports. As a result, we found that the product dimension of existing competition between different retailers of Sky Movies (currently Sky and Virgin Media) was at least as wide as these Sky Movies packages, which included basic pay TV and in most cases Sky Sports. However, it appeared to us that competition between traditional pay-TV retailers was not limited to such packages and, in the light of this, we considered that a narrow market definition limited to Sky Movies was unlikely to provide a suitable framework within which to assess retail competition.

4.6 Nevertheless, given the focus on Sky Movies in our terms of reference, we also considered the application of the hypothetical monopolist test to test whether there might be an economic market limited to Sky Movies.

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[1] *Market Investigation References: Competition Commission Guidelines, CC3*, June 2003.
[2] *CC3*, paragraph 2.2.
[3] In this respect, there was no disagreement as regards the retail and wholesale markets (in so far as some parties considered there to be a wholesale market). In its comments on the rights market, Sky suggested the geographic scope may be wider than the UK—see paragraphs 4.167 & 4.168 and 4.156.
[4] We define Sky Movies products as pay-TV content that is sold for a clearly defined price—typically a pack of channels or group of such packs; the Sky Movies products are those products that include Sky Movies packs—some of these also include Sky Sports packs (eg dual movies/dual sports).
[5] For a period there was a limited exception to this—see first footnote to paragraph 2.98.

4.7 First, we carried out an assessment of the substitutability of other specific products and services for Sky Movies as follows:

(a) We considered whether particular products (ie DVDs, EST, movies on FTA TV and basic pay channels, cinema, PPV/TVOD and other movies subscription services already existing at the start of our inquiry) were close substitutes for Sky Movies packs. We analysed the prices of Sky Movies and these products and investigated whether the demand for Sky Movies was related to the relative prices between it and any of these products (see Appendix 4.1). We found that there was no close correlation between the prices of these products and Sky Movies, and that demand for Sky Movies did not appear to respond to changes in relative prices. Therefore, on the basis of this analysis, it did not seem to us that any one of these products was a close substitute for Sky Movies.

(b) Next, we considered whether the OTT services of Netflix and LOVEFiLM were substitutes for Sky Movies. We found that there were a number of similarities between the OTT services of LOVEFiLM and Netflix and Sky Movies, in particular all offer a wide range of films, with at least some in HD, and they are all available on a subscription basis, but we also noted significant differences. Moreover, due to the short time since the start of these services, there was inevitably some uncertainty about their impact. We observed that the results from our February 2012 survey suggested that the new services were likely to have some impact on subscriptions to Sky Movies. However, some caution was needed in interpreting these survey responses and other evidence suggested that the LOVEFiLM/Netflix services would have a limited impact on subscriptions to Sky Movies, at least in the short term.[6] On the basis of this evidence, we concluded that the new OTT services of LOVEFiLM and Netflix were substitutes for some existing and some prospective Sky Movies subscribers, but this population was not sufficiently large to render these services a close demand-side substitute for Sky Movies.

(c) Nevertheless, we noted that each of the services of LOVEFiLM and Netflix was a closer substitute for Sky Movies than other movie services such as BT's Vision Film and PictureBox. Looking to the future, we also noted that there was some evidence to suggest that, over time, these services were likely to become substitutes for more Sky Movies subscribers, although we did not expect these services to become close substitutes for Sky Movies in the foreseeable future.

(d) We also considered Sky's new OTT service, Now TV, which launched in July 2012 and offers Sky Movies on an unbundled basis (ie without requiring a subscription to any other pay-TV content) and, subsequently, is expected to offer a range of pay-TV content. In our view, Now TV competes to some extent with the existing OTT services of LOVEFiLM and Netflix. However, we noted that even if the OTT services of LOVEFiLM and Netflix were to be the nearest substitute for Sky Movies on Now TV, they would not become a close substitute for Sky Movies on traditional pay TV, and it appeared likely to us that, for the foreseeable future, traditional pay TV would continue to account for the large majority of Sky Movies subscribers. On this basis, we concluded that the OTT services of LOVEFiLM and Netflix were not a close substitute for Sky Movies overall (when considered regardless of the way in which Sky Movies is distributed to customers).

4.8 Nevertheless, what matters from a market definition perspective is the total strength of all the substitutes to Sky Movies collectively and, therefore, we considered the

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[6] In particular, [✂] and [✂] indicated that, [✂]. Furthermore, we noted evidence from the USA and Canada which suggested that, in those geographic markets, the presence of Netflix had not yet had a significant impact on subscriptions to premium movie services on pay-TV there.

aggregate constraint on Sky Movies and its implications for market definition. We considered evidence relating to how consumers would respond to increases in the price of Sky Movies packs above the current level on the basis that, in principle, such evidence could be used to calculate the loss in revenue to retailers from increasing the price of Sky Movies packs and, hence (given assumptions on marginal costs), whether it would be profitable for a hypothetical monopolist over Sky Movies packs to increase prices compared with the current price of Sky Movies packs (in the absence of supply-side constraints).

4.9 However, a significant problem with this approach was that, in practice, Sky is the retailer of Sky Movies on its own platform, on TalkTalk's platform and on the Internet[7] and, as a wholesaler, it also determines the price at which it provides Sky Movies to Virgin Media (and other cable operators). Therefore, Sky is close to being an actual, rather than a hypothetical, retail monopolist over the Sky Movies packs and also benefits from bidding advantages derived from having significantly more Sky Movies subscribers on its platform than its rivals. Given that an actual retail monopolist of Sky Movies packs who benefits from bidding advantages (which undermine the supply-side constraints) would be expected to have increased prices to the point where it was no longer profitable to impose further price rises, a finding that price rises over the current level would be unprofitable would have no clear implications for market definition because current prices may very well exceed the competitive prices that are the proper starting point for such an exercise.[8]

4.10 In seeking to apply the hypothetical monopolist test to the retailing of Sky Movies packs, we needed to compare the incremental price that a hypothetical retail monopolist would charge with the incremental price that would prevail in a competitive market for Sky Movies packs. In principle, there were two approaches which we might have taken:

(a) We could have attempted to compare the hypothetical monopoly price and the competitive price in the presence of all other existing characteristics of traditional pay-TV retailers, including in particular bundling of Sky Movies packs with basic pay-TV and in some cases Sky Sports. However, such bundling implied that the incremental price of Sky Movies depended on the price of other products in the bundle and hence on competition across these other products. Therefore, under this approach, it appeared to us that assessing the competitive price of Sky Movies required analysis within a broader market than Sky Movies packs.

(b) We could have sought hypothetically to separate retailing of Sky Movies from other aspects of traditional pay-TV retailing and focus only on stand-alone retailing of Sky Movies. Under this approach we would consider whether a stand-alone retail monopolist over Sky Movies without Sky's other attributes (ie its pay-TV platform and large number of subscribers to basic pay-TV channels and Sky Sports) would be able to impose a small but significant non-transitory increase in price (SSNIP) over the competitive price. However, it appeared to us that the idea of a hypothetical retail monopolist over just one specific type of pay-TV content was rather artificial since content was almost always bundled together, and there was very little self-retailing by broadcasters/content aggregators on traditional pay-TV platforms. Nevertheless, as an alternative approach, which could have indicated that a narrower market ought to have been adopted, we considered it, despite its artificiality. However, we found that it was unlikely that such a hypo-

[7] Via the Sky Go monthly ticket and also via Now TV.
[8] This is known as the 'cellophane fallacy'—see *CC3*, paragraphs 2.9 & 2.10.

thetical monopolist would be able to impose a SSNIP compared with the competitive price.

4.11 Therefore, in our view, neither of these approaches led to a retail market as narrow as Sky Movies. We concluded that we needed to assess competition at the retail level within a frame of reference which was wider than this, reflecting the nature of traditional pay-TV retail competition and including other products which are relevant to competition between traditional pay-TV retailers for subscribers. Accordingly, we did not adopt a narrow retail market definition limited to Sky Movies packs, products or packages.

4.12 In light of this analysis and finding, we then considered what other products or services should be included in the relevant product market. It appeared to us that:

(a) In addition to Sky Movies, the pay-TV retail market should include at least basic pay-TV products (included in all traditional pay-TV subscriptions) and Sky Sports (an important driver of many pay-TV subscriptions) since we had found that these products were closely connected in the process of rivalry for subscribers to pay-TV packages. Not to include these products would, in our view, result in an assessment which was a poor proxy for the reality of competition.

(b) SVOD-only products offered by traditional pay-TV retailers should be included in the retail market definition since, in making a decision to subscribe to traditional pay-TV or to continue with a traditional pay-TV subscription, SVOD-only products such as BT's Vision Film and PictureBox were part of the choice offered by traditional pay-TV retailers, in the same way as hybrid linear/SVOD products (such as Sky Movies) and linear-only products.

(c) Now TV was highly relevant to our assessment of competition and should be included in the retail market definition. This was because we noted that Sky Movies on Now TV offers substantially the same content as Sky Movies on traditional pay TV, and its price is similar to the incremental price of Sky Movies on traditional pay TV (when not bought with Sky Sports).

4.13 We found there to be sufficient rivalry between the SVOD services provided OTT by LOVEFiLM and Netflix and traditional pay-TV to include them in the retail market definition. Whilst we found that these services were closer competitors to each other than to packages of traditional pay-TV and were significantly differentiated from Sky Movies on Now TV, it appeared to us that Sky's decision to distribute Sky Movies as the first content available on Now TV, and to do so on an unbundled basis, was at least in part a response to the perceived competitive threat from LOVEFiLM and Netflix.[9] Other evidence also supported there being some competitive interaction between these services.[10]

4.14 It was less clear that TVOD/PPV services and à la carte channels influenced consumers' pay-TV subscription decisions. We saw little evidence relevant to this question and we did not think it necessary to reach a view on whether these services were within or outside the pay-TV retail market in order to assess pay-TV competition. With regard to TVOD services, we recognized that, given the large number of well-

[9] We noted that the launch of Sky Movies on Now TV reduced the minimum price of accessing Sky Movies from £32 to £15 (see Appendix 4.2), which represented a substantial effect.
[10] Though the extent of interaction between traditional pay TV and OTT was uncertain, it did not appear to us to be of a different order of magnitude from that between different traditional pay-TV retailers. The available evidence suggested that about 6 per cent of traditional pay-TV subscribers switched between retailers per year (see paragraph 5.29), while our February 2012 survey suggested that, in 2012, OTT services might impact on around 3 per cent of subscribers to traditional pay TV (see Appendix 4.2).

resourced retailers now offering these services (see paragraph 2.134) and the widespread provision and increasing adoption of them, they might represent an increasing constraint on SVOD services, which could affect competition in the pay-TV retail market (including for packages of traditional pay TV and SVOD services). However, we remained uncertain about the implications of these developments and we had little evidence on the relative take-up of either TVOD/PPV services or à-la-carte channels. Overall, it appeared to us that it was not necessary for us to reach a view on whether TVOD/PPV services or à-la-carte channels were within or outside our pay-TV retail market definition in order to assess competition.

4.15 At this stage of our analysis we found, therefore, that our retail market definition included both traditional pay-TV packages and OTT SVOD services. Having reached this conclusion, we considered next whether it was wider still, having regard both to product characteristics and the way in which rivalry occurs and to an assessment of whether a hypothetical monopolist of pay-TV would be able profitably to impose a SSNIP.

4.16 In applying the SSNIP test in this context, we noted that Sky was the pay-TV retailer with by far the largest number of existing subscribers, and Virgin Media had most of the remaining pay-TV subscribers and that therefore the constraints imposed by Virgin Media on Sky, and vice versa, were key to assessing the extent to which a hypothetical pay-TV monopolist could charge higher prices than those charged by existing pay-TV retailers. Other evidence was consistent with a hypothetical pay-TV retail monopolist being able profitably to increase prices above existing levels by a SSNIP, in particular:

(a) econometric analysis based on differences in Sky's penetration across local areas in 2008;[11] and

(b) Sky's competitor monitoring which suggested that other traditional pay-TV retailers (Virgin Media and BT) were its closest competitors, and a more significant constraint than non-pay-TV companies (eg FTA broadcasters), although this evidence did not enable any quantification.[12]

4.17 Given that the hypothetical monopolist test should be carried out at competitive prices, we considered how the evidence considered above, which related to existing price levels, should be interpreted. We noted that, to the extent we believed competition between pay-TV retailers to be ineffective,[13] existing average prices were likely already to be above the competitive level. This suggested that the prices charged by a hypothetical monopolist would be further in excess of competitive prices than they are of existing prices, which increased our confidence in our view that pay-TV retailing was not too narrow a market definition.

4.18 We also considered the role of communications products and FTA TV. Overall, we found that the pay-TV retail market was separate from a market for communications products, although we recognized that features of one market could affect another and features of the pay-TV market could have effects in related communications markets, and vice versa. Similarly, whilst we accepted that the pay-TV retail market was affected by FTA TV, we were not persuaded that FTA TV should be included in the same market as retail pay TV. Therefore, it appeared to us that communications products and FTA TV should be considered as 'out-of-market constraints', ie factors

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[11] This provided some evidence of the constraint that Virgin Media imposes on Sky—see Appendix 4.6.
[12] See Appendix 4.7.
[13] See Section 5.

which are outside the market but which we nevertheless take into account in our assessment of competition.

The wholesale level

4.19 We considered that the wholesale market could be approached in two ways:

(a) It could relate to the actual wholesale supply of Sky Movies by Sky to Virgin Media and other retailers. This is referred to in our terms of reference but it represents a small part of the overall sale of Sky Movies (see Table 2.4).

(b) It could be expanded to include a notional wholesale supply of Sky Movies from Sky (as a notional wholesaler) to Sky (as a retailer), ie Sky's self-supply. The total actual and notional wholesale supply of Sky Movies was the wholesale market which Ofcom defined in its Pay TV Statement.

4.20 The latter approach (total wholesale supply) was based on the idea that there could be one or more wholesaler selling Sky Movies to retailers, in other words that wholesaler(s) are vertically separated from retailers. Therefore, we considered whether a stand-alone wholesale monopolist over Sky Movies without Sky's other attributes[14] would be able to impose a SSNIP compared with the price prevailing if there were two or more stand-alone wholesale suppliers of movies products with FSPTW content from the six major studios. In our view, it would only have been meaningful to say that Sky had market power arising specifically from its position as a wholesaler of Sky Movies if this was the case.

4.21 Our assessment suggested that:

(a) A hypothetical stand-alone wholesaler of Sky Movies would be constrained to some extent by services with content other than FSPTW content from major studios (see paragraph 4.125*(a)*) and by the possibility of others acquiring FSPTW content from major studios (see paragraph 4.125*(c)*).

(b) These points in turn suggested that a stand-alone monopolist wholesale supplier of Sky Movies would have no sustainable source of market power as it would have no direct contact with the customers responsible for the demand for its product.

(c) Thus, over time, such a supplier could be disintermediated by the pay-TV retailers/platforms which did have this contact with customers.

For these reasons, we did not think there was a separate wholesale market for Sky Movies.

4.22 Notwithstanding this finding, we recognized that a stand-alone monopolist wholesaler of Sky Movies with medium- or long-term studio contracts would, over the term of those contracts, face no constraint from the possibility of others acquiring rights directly,[15] and it may, consequently, have an apparent ability to price above the competitive level during the term of those contracts. However, we would expect retailers to have negotiated similar medium- or long-term contracts with the wholesaler in order to capture the wholesale price at the point of competitive bidding and thus we

[14] Its pay-TV retailing activity and its Sky Sports and basic channels.
[15] Though it would still be constrained by the substitutability of other content.

did not consider that this factor would enable a stand-alone monopolist wholesaler of Sky Movies to impose a SSNIP.

4.23 Next we considered Sky's actual wholesale supply of Sky Movies products, which comprised only a small part of the total wholesale supply. The hypothetical monopolist test involves asking whether a hypothetical monopolist would be able profitably to increase prices above the competitive level. However, as Sky is an actual wholesale monopolist over Sky Movies, this test equated to asking whether the competitive price would be below Sky's actual wholesale price by at least a SSNIP. It seemed to us that this question was similar to the question of whether our theory of harm (see paragraph 3.6) was valid as, if our theory of harm, including circumstance *(d)* (referred to in paragraph 3.9*(d)*), was valid, then it would follow that Sky's wholesale prices for Sky Movies were above the competitive level;[16] while, if our theory of harm was not valid, then we would not be able to say that Sky's wholesale prices for Sky Movies were above the competitive level and we would not be able to define a wholesale market.

4.24 Accordingly, we did not think that adopting for the purposes of our inquiry a market definition limited to Sky's actual wholesale supply of Sky Movies could lead to an appropriate framework for assessing our theory of harm as this would be close to assuming what we were setting out to test (if the wholesale supply of Sky Movies was defined as a market, it would follow that Sky had a monopoly of that market and, therefore, that there was an absence of competition in that market).[17]

4.25 We also considered whether there was a need for the purposes of our inquiry to assess competition within a wider market for the wholesale supply and acquisition of pay-TV content but decided that this was not necessary. We recognized that our terms of reference referred to the wholesale supply and acquisition of packages including Sky Movies channels but we did not believe that our analysis of competition relevant to this supply and acquisition was limited by our decision not to define a wholesale market. We set out as part of our theory of harm how matters relating to Sky's wholesale supply of FSPTW content and Sky Movies to other pay-TV retailers fell to be considered and have referred to Sky's wholesale supply as appropriate throughout our analysis.

The rights level

4.26 We first considered whether there was a separate market for movie rights from the major studios (mentioned in our terms of reference) or whether the market definition should include movie rights from all studios. We acknowledged that, if we were able to carry out the hypothetical monopolist test starting with the movie rights of the six major studios, we might conclude that these studios could impose a SSNIP over the supply of their rights because the six major studios account for a large share of revenue and viewing. However, we did not regard this as an appropriate application of the hypothetical monopolist test as the test should start with a product definition, and there seemed no reason to us why movies distributed by the six major studios should be regarded as a different product from movies distributed by non-major studios. Further, although smaller suppliers of a product (often referred to as a com-

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[16] Even though we did not see a sustainable source of market power arising simply from wholesaling Sky Movies, it was possible that, as envisaged in our theory of harm, Sky's wholesale price of Sky Movies was above the competitive level due to Sky's retail market power.
[17] A further illustration that Sky's actual wholesale supply of Sky Movies was not an appropriate framework for assessing our theory of harm was that no such market would exist if Sky made no wholesale supply of Sky Movies to any other retailer. A situation where no supply is made (and hence where there is no market) is similar to a situation where there is supply but at a high price (and hence where there is a market 'monopolized' by Sky).

petitive fringe) will typically exercise a limited constraint on the larger suppliers, this does not mean that smaller suppliers should be excluded from the market definition. Accordingly, we believed that the starting point for the hypothetical monopolist test should be all rights to content generally understood as movies and, therefore, in principle, we included FSPTW rights to all movies in the market.

4.27 We judged that the market should not be widened to include rights to non-movie TV programmes because:

(a) whilst the nature and focus of TV channels could change over time and other content can be a substitute for FSPTW content within movie products, we saw no evidence to suggest either that Sky would change materially the type of content shown on Sky Movies[18] or that a SSNIP applied to movie rights would induce such a change; and further

(b) even if substitutability of individual movies was sometimes weak, overall, a hypothetical monopolist movie supplier would still be in a stronger negotiating position than the studios are currently, even if licensing rights in a particular window to a powerful licensee (such as FSPTW rights to Sky).

4.28 As to whether the market should be limited to FSPTW movie rights or should cover all movie rights, we concluded that the appropriate frame of reference for our analysis of issues in relation to the supply and acquisition of FSPTW movie rights was a price discrimination market limited to FSPTW movie rights. This was due to the distinctive characteristics of FSPTW rights compared with rights for other windows (see paragraphs 4.160 to 4.162). Whilst we accepted that there was substitution on the demand side between rights in different windows, and that there could be substitution between products which included movie content from different windows, we observed that the FSPTW was temporally distinct from other windows (except the DVD and EST windows[19]), which implied that substitution between rights in different windows was sufficiently weak for them to remain separate. Again, this did not preclude us from considering a broader range of movie rights or movie content where necessary for our analysis.

Background

4.29 Ofcom referred to us for investigation the supply and acquisition of subscription pay-TV movie rights in the FSPTW from the six major studios and the wholesale supply and acquisition of packages including core premium movies channels (defined as Sky Movies channels—see Section 1). During the period of our inquiry, and for many years previously, Sky has held the FSPTW rights of all the major studios and it exhibits this content on its Sky Movies channels and within its associated SVOD services. However, as noted in our guidelines, the relevant economic market may not coincide with the particular goods or services that are described in the reference.[20]

4.30 As a general point, we noted that TV services are characterized by low marginal costs, ie the cost of producing and transmitting content to an additional viewer is low (and, because of this, content is sometimes described as a public good). Content suppliers, including movie studios, receive fees for granting TV companies the rights

[18] Although in the past it has occasionally shown TV series on Sky Movies.
[19] This does not apply to the DVD or EST windows as they are contemporaneous with the FSPTW, but our analysis in Appendices 4.1 and 4.8 suggested that DVD and EST products were not close substitutes for the products based on content in the FSPTW, and consequently we were satisfied that it remained reasonable to define a price discrimination market limited to FSPTW movie rights.
[20] *CC3*, paragraph 1.21.

to distribute their content to viewers, and it is the prospect of earning such fees (among other things) that gives content suppliers the incentive to produce the content.

4.31 As noted above, in the course of our inquiry we assessed all relevant levels of supply, ie the rights level, the wholesale level and the retail level (see paragraph 4.4). However, as the demand for wholesale services and for FSPTW rights is ultimately derived from a demand by consumers for retail services, we considered first the retail level, then the wholesale level, and then the rights level.

Retail market definition

4.32 We set out in Section 2 the products which include Sky Movies channels and the prices of those products and also the other pay-TV products with movie content available to consumers. In light of that background, we considered the appropriate retail market definition, including *(a)* whether there were close substitutes for Sky Movies, and *(b)* whether our retail market definition should be limited to Sky Movies or whether it should be widened to include all pay TV (including sports and other content), or widened further (for example, to include FTA TV or telephony and broadband services).

4.33 As an initial observation, we noted that, until the launch of Sky Movies on Now TV shortly before the end of our inquiry, it was not possible for pay-TV consumers to subscribe to Sky Movies packs or Sky Movies products on a stand-alone basis, ie without a basic pay-TV subscription.[21] Moreover, a high proportion of Sky Movies subscribers take a package including Sky Sports. As a result, it appeared to us that the product dimension of existing competition between different retailers of Sky Movies (currently principally Sky and Virgin Media) was at least as wide as these Sky Movies packages, which included basic-pay TV and in most cases Sky Sports.

4.34 This was supported by evidence that consumer decisions about which pay-TV retailer to subscribe to were often separate from decisions about whether or not to subscribe to Sky Movies. We found that about [✂] per cent of new Sky Movies subscribers on the Sky platform were upgrading from an existing Sky package without Sky Movies and a similar proportion of those who stopped subscribing to Sky Movies were downgrading to another Sky package.[22]

4.35 We observed that competition between traditional pay-TV retailers was principally to acquire and retain subscribers on their pay-TV platforms and that it had been rare for traditional pay-TV retailers to offer specific content genres, including movies, separately from basic pay TV and an STB with PVR functionality (see Section 5).[23]

4.36 We also noted that most traditional pay-TV advertising mentioned different aspects of a pay-TV service, for example both content (and sometimes more than one type of content, eg both TV programming and movies) and a technological attribute (such as the functionality of an STB). We observed that while some advertising focused on a specific aspect of a service, for example a specific piece of content or technological

[21] From September 2009 to August 2011, it was possible to purchase Sky Movies on the Sky platform without basic channels from Sky's call centre for a reduction of £1 per month compared with the price with one entertainment pack (see first footnote to paragraph 2.98). However, this product was not actively marketed by Sky.
[22] This was based on our analysis of Sky data for the 12 months to end September 2010.
[23] For example, BT told us that Vision Film was available on a stand-alone basis (ie not bundled with a basic pay-TV product) but said that [✂].

attribute, this was not as common and, where it occurred, the focus tended to vary according to the time of year.[24]

4.37 Overall, this evidence suggested that competition between traditional pay-TV retailers was not limited to specific content genres, such as Sky Movies, but was across many pay-TV products and packages.

A market limited to Sky Movies?

4.38 On this basis, it appeared to us that a narrow market definition limited to Sky Movies was unlikely to provide a suitable framework in which to assess retail competition.

4.39 Nevertheless, given the focus on Sky Movies in our terms of reference, we considered the application of the hypothetical monopolist test[25] to identify whether there was an economic market limited to Sky Movies. We considered three possible definitions of the product (the narrowest first):

(a) Sky Movies packs[26] (at a retail level, these packs (eg dual movies) may be regarded as the focus of our inquiry because they represent the only retail packs which include the FSPTW movie rights of the major studios, as referred to in our terms of reference).

(b) Sky Movies products[27] (ie all products that include Sky Movies packs and have a clearly defined incremental price, eg dual movies/dual sports). This definition differs from *(a)* in that some of these products include Sky Sports packs. The content in these retail products equates to that in the wholesale 'packages' referred to in our terms of reference (except that the wholesale packages do not include the Disney Cinemagic channels).

(c) Sky Movies retail packages[28] (ie all retail pay-TV packages that include Sky Movies products, eg dual movies/dual sports and the basic Entertainment pack[29]). This differs from *(b)* in that it also includes all packs of basic channels and other pay-TV services purchased by subscribers to Sky Movies products. This was the retail market definition used by Ofcom in its Pay TV statement.

We focused initially in this analysis on Sky Movies within traditional pay TV. However, as already noted (see paragraph 4.7), Sky now provides Sky Movies on an unbundled OTT basis (so for this new service, Sky Movies will be pack, product and package in the language of this section). We consider this new service further in paragraphs 4.46 to 4.49 and 4.68.

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[24] For example, Sky always advertises Sky Movies in the pre-Christmas period, though its advertising may also refer to Sky Movies at other times of year as well.
[25] The principle behind this test is that a market is defined as a product, or collection of products, the supply of which can, hypothetically, be monopolized at prices above competitive prices. It is usually implemented by starting with a narrow market and widening it until a hypothetical monopolist could profitably impose a SSNIP above competitive prices. However, as noted in our guidelines, it is rarely possible to apply the test in a direct sense and it is therefore usually necessary for us to infer, from whatever information is available, or can be collected, what the likely outcome of the test would be.
[26] We defined pay-TV packs as a group of channels and/or VOD content—the Sky Movies packs are Movies 1, Movies 2 and dual movies (dual movies customers may also have VOD access to Sky Movies content (ie via Anytime+, Sky Go and Now TV)).
[27] We defined a pay-TV product as pay-TV content which is sold for a clearly defined price—typically a pack of channels or group of such packs..
[28] We defined a pay-TV package as all subscription pay-TV products purchased by a subscriber from a specific retailer (including à la carte channels but excluding TVOD/PPV content).
[29] This is a Sky retail package which includes Sky Movies packs. Other pay-TV retailers have other retail packages which include Sky Movies packs.

4.40 We began by considering the first of the three possible narrow retail market definitions, the Sky Movies packs—essentially, the Sky Movies channels and the associated VOD services available prior to the launch of Now TV.[30] We then considered whether, if it was inappropriate to define a market around the Sky Movies packs, we should define a market around either Sky Movies products or Sky Movies packages.

4.41 Although we considered first whether other products were individually close substitutes for Sky Movies, this was not of itself determinative of whether those other products should be included within the relevant market.[31] What matters from a market definition perspective is the total strength of the constraint exercised by all substitutes collectively, and we recognized that, where individual products are differentiated, a product may not have any single close substitute but nonetheless may not constitute a separate market if its price is constrained by the collective effect of a number of substitutes, including differentiated products and those offered by smaller suppliers or new entrants.

Sky Movies packs

- *Are other products individually close substitutes for Sky Movies?*

4.42 Sky and the six major studios all told us that differences in product characteristics represented product differentiation rather than implying a separate market.[32] These parties said that there were many substitutes for Sky Movies including DVDs (sale and rental), EST, movies and other programmes on FTA TV and basic pay channels, and movies provided on a PPV and TVOD basis.

4.43 If one or more of these other products was a close substitute for Sky Movies, the price of the close substitute product would largely determine the price of Sky Movies and demand for Sky Movies would be linked to the relative price of Sky Movies to the close substitute product. This would imply widening the market to include the close substitute product or products. In Appendix 4.1 we analyse the prices of Sky Movies and other products and investigate whether the demand for Sky Movies is related to the relative prices between it and these other products. We concluded that there was no close correlation between the prices of these other products and Sky Movies, and demand for Sky Movies did not appear to respond to changes in relative prices. Therefore, on the basis of this analysis, it did not seem to us that any of these other products was a close substitute for Sky Movies.

- *Substitutability of LOVEFiLM and Netflix services for Sky Movies*

4.44 We discuss the extent to which the services of LOVEFiLM and Netflix are substitutes for Sky Movies in Appendix 4.2 (see also Section 6). We found that:

(a) There were a number of similarities between the OTT services of LOVEFiLM and Netflix and Sky Movies, in particular all offer a wide range of films, with at least some in HD, and they are all available on a subscription basis.

(b) There were also, however, significant differences between the OTT services of LOVEFiLM and Netflix and Sky Movies. In particular, the OTT services of

[30] The dual movies pack also includes the Disney Cinemagic channels.
[31] We consider that another product would be a close substitute to Sky Movies if a small reduction in its price relative to that of Sky Movies led to a significant reduction in subscriptions to Sky Movies (see Appendix 4.1, paragraph 2).
[32] One studio (Sony Pictures) put it slightly differently. It said that platforms for content delivery within the home all competed with each other for viewership and did not represent separate markets.

LOVEFiLM and Netflix cost significantly less than Sky Movies,[33] have no minimum contract period, and have a greater number of movies available to watch (and non-movie content), but have much less FSPTW content than Sky Movies. Other differences include that LOVEFiLM and Netflix do not present their content in linear channels whereas most consumption of Sky Movies is still on this basis; and LOVEFiLM and Netflix are both currently available on more devices than Sky Movies (including via Now TV and Sky Go), although over time we expected Sky to add more devices.

(c) Due to the short time period since the start of these OTT services, there was necessarily little measurable evidence of their impact. The results of our survey, conducted in February 2012 (see Appendix 4.3), suggested that 27 per cent of those likely to subscribe to LOVEFiLM/Netflix were at that time or recently taking Sky Movies and, of that group, around one-third indicated that they had already stopped, or were likely in the near future to stop, subscribing to Sky Movies and gave as a reason that they ‘now watch TV on LOVEFiLM/Netflix’ (whereas about two-thirds indicated that they were likely to continue to subscribe to Sky Movies). This suggested that the new services were likely to have some impact on subscriptions to Sky Movies. However, given the short period since the launch of these OTT services, we acknowledged that some caution was needed in interpreting these survey responses (see Appendix 4.2).

(d) Some other evidence also suggested that the OTT services of LOVEFiLM and Netflix would have a limited impact on subscriptions to Sky Movies, at least in the short term. In particular, [✂] and [✂] indicated that, [✂]. Furthermore, evidence from the USA and Canada suggested that the presence of Netflix had not yet had a significant impact on subscriptions to premium movie services on pay-TV there.

4.45 On the basis of this evidence, we concluded that the new OTT services of LOVEFiLM and Netflix were substitutes for some existing and some prospective Sky Movies subscribers. We found these services to be a closer substitute than other movie services such as BT’s Vision Film and PictureBox. However, we did not believe that the population of existing and future subscribers for whom LOVEFiLM and Netflix were substitutes for Sky Movies was sufficiently large to render either of these OTT services a close demand-side substitute for Sky Movies for the purpose of this initial stage of our market definition analysis. Nevertheless, as we found them to be substitutable for some Sky Movies subscribers, we considered whether to include these OTT services in the market as they contributed to the total collective constraint on Sky Movies (and also because they competed more directly with Sky Movies on Now TV) (see paragraph 4.69). Further, looking to the future, we noted that there was some evidence to suggest that, over time, these services were likely to become substitutes for more Sky Movies subscribers,[34] although we did not expect either of these OTT services to become a close substitute for Sky Movies in the foreseeable future.

- *Treatment of Sky Movies on Now TV*

4.46 Sky launched its new OTT service, Now TV, in July 2012, offering just Sky Movies at an unbundled price of £15 (see Appendix 4.2). Consumers of Sky Movies on Now TV have access to the full range of dual movies content (other than Disney Cinemagic and MGM HD).

[33] Especially for those Sky Movies subscribers who do not take (or do not attach a lot of value to) Sky Sports.
[34] We set out in Appendix 4.2 the factors which we expected would increase the substitutability of OTT services for Sky Movies.

4.47 As an OTT service which offers Sky Movies but is expected subsequently to offer a range of pay-TV content, Now TV competes to some extent with the existing OTT services of LOVEFiLM and Netflix. We noted that Sky's internal documents indicated that it was targeting this service at [✂], and we expected these customers also to be targeted by LOVEFiLM and Netflix, [✂]. However, it appeared to us that, even if LOVEFiLM and Netflix became the nearest substitutes for Sky Movies on Now TV, they would still not be close substitutes for Sky Movies on traditional pay TV and, in our view, it was likely that, for the foreseeable future, traditional pay TV would continue to account for the large majority of Sky Movies subscribers.[35]

4.48 On this basis, we concluded that LOVEFiLM and Netflix were not close substitutes for Sky Movies overall (when considered regardless of the way in which it is distributed to customers).

4.49 We noted that, although Sky Movies can be considered as a single product, there is nevertheless some differentiation between Sky Movies as offered through Sky and Virgin Media as traditional pay-TV retailers and Sky Movies as offered on Now TV (eg the consumer experience, contract terms, price, etc). However, on the basis of the similarity of the content on the two services, it appeared to us likely that the closest substitute to Sky Movies as offered through a traditional pay-TV retailer would become Sky Movies as available on Now TV. This observation was important when we came to consider the significance of Sky Movies to consumers in their choice of traditional pay-TV retailer (see Section 6).

- *Collective constraint*

4.50 Sky argued that it was the total strength of substitutes that mattered for market definition and that, in aggregate, Sky Movies faced a strong constraint even if it had no close substitute. We agreed that what mattered from a market definition perspective was the total strength of all the substitutes to Sky Movies collectively, and noted that this consideration was particularly relevant to a proposed market where there was a single supplier.[36] Therefore, we considered the aggregate constraint on Sky Movies and its implications for market definition.

4.51 We first considered evidence relating to consumers' responses to increases in the price of Sky Movies packs (see Appendix 4.4). In principle, evidence on consumers' responses may be used to calculate the loss in revenue to retailers from increasing the price of Sky Movies packs and hence (given assumptions on marginal costs) whether it would be profitable for a hypothetical monopolist over Sky Movies packs to increase prices compared with the current price of Sky Movies packs (in the absence of supply-side constraints). However, a difficulty in this case was that Sky is the retailer of Sky Movies on its own platform, on TalkTalk's platform and on the Internet[37] and, as a wholesaler, it also determines the price at which it provides Sky Movies to Virgin Media (and other cable operators). Therefore, Sky is close to being an actual, rather than a hypothetical, retail monopolist over the Sky Movies packs and also benefits from bidding advantages derived from having significantly more Sky Movies subscribers on its platform than its rivals. An actual monopolist of Sky Movies packs who benefits from bidding advantages (which undermine the supply side constraints) would be expected to have increased prices to the point where it was no longer profitable to impose further price rises and, in these circumstances, a

[35] Sky's projections (see paragraph 5.156) indicated that, by June 2017, Sky Movies on Now TV might have between [✂] and [✂] subscribers, which would represent about [✂] per cent of the total number of Sky Movies (based on the current number of subscribers on the Sky and Virgin Media platforms).
[36] Sky is the only supplier of Sky Movies and we had found Sky Movies to have no close substitutes.
[37] Via the Sky Go monthly ticket and also via Now TV.

finding that price rises over the current level would be unprofitable would have no clear implications for market definition. Instead, current prices need to be compared with competitive prices,[38] but making such a comparison is far from straightforward. Moreover, the issue of whether Sky charges more for Sky Movies than would be the case if there were more competition was central to our inquiry, and it appeared to us that a market definition which simply assumed that the Sky Movies price was above the competitive level would not establish a suitable framework for our analysis.[39]

4.52 In seeking to apply the hypothetical monopolist test to the retailing of Sky Movies packs, we needed to compare the incremental price that a hypothetical retail monopolist would charge with the incremental price that would prevail in a competitive market for Sky Movies packs. In principle, there were two approaches which we might have taken:

(a) We could have attempted to compare the hypothetical monopoly price and the competitive price in the presence of all other existing characteristics of traditional pay-TV retailers, including in particular bundling of Sky Movies packs with basic pay-TV and in some cases Sky Sports. However, such bundling implied that the incremental price of Sky Movies depended on the price of other products in the bundle and hence on competition across other products, encompassing at least basic pay TV and Sky Sports as well as Sky Movies products. Therefore, under this approach, it appeared to us that assessing the competitive price of Sky Movies required analysis within a broader market.

(b) We could have sought hypothetically to separate retailing of Sky Movies from other aspects of traditional pay-TV retailing and focused only on stand-alone retailing of Sky Movies. Under this approach we would have considered whether a stand-alone retail monopolist over Sky Movies without Sky's other attributes (ie its pay-TV platform and large number of subscribers to basic pay-TV channels and Sky Sports) would be able to impose a SSNIP over the competitive price. However, it appeared to us that the idea of a hypothetical retail monopolist over just one specific type of pay-TV content was rather artificial since content is almost always bundled together, and there is very little self-retailing by broadcasters/content aggregators on traditional pay-TV platforms. Nevertheless, as an alternative approach, which could have indicated that a narrower market ought to have been adopted, we considered it, despite its artificiality.[40] Under this approach, we found it was unlikely that such a hypothetical monopolist would be able to impose a SSNIP compared with the competitive price (see Appendix 4.5).

4.53 Neither of these approaches led us to find a retail market as narrow as Sky Movies packs.

- *Finding on Sky Movies packs*

4.54 Overall, we did not believe that we should define a market limited to Sky Movies packs.

[38] This is known as the 'cellophane fallacy'—see *CC3*, paragraphs 2.9 & 2.10.
[39] This is a well-known problem in using market definition to identify existing market power that is referred to in our draft new market guidelines (see paragraph 137):
www.competition-commission.org.uk/assets/competitioncommission/docs/2012/consultations/market_guidlines_main_text.pdf.
[40] This approach would be appropriate if effective pay-TV competition required retailing of Sky Movies to be separate from other aspects of retailing, including provision of the platform, and that cannot just be assumed.

Sky Movies products

4.55 Sky Movies products (definition *(b)* in paragraph 4.39) differ from Sky Movies packs only in having a clearly defined incremental price. We did not consider it appropriate to seek to apply the hypothetical monopolist test at the level of Sky Movies products since such a market definition would include some packs (Sky Sports) in the market when purchased by subscribers who also purchased Sky Movies channels, but would exclude them when purchased by subscribers who did not purchase Sky Movies packs. The concept of a market is usually based around a product or group of products,[41] implying that when sold by the same company other products (such as Sky Sports) should either be outside or inside the market and not partially in and partially out as under definition *(b)* in paragraph 4.39.[42]

Sky Movies packages

4.56 Sky Movies packages represented an alternative focal product to which to apply the hypothetical monopolist test, which took into account that subscribers to traditional pay TV purchase Sky Movies as part of a package with other pay TV. However, it appeared to us that taking Sky Movies packages as the starting point for the hypothetical monopolist test gave rise to the same difficulty with determining the competitive price as arose if Sky Movies packs were taken as the focal product (ie that the competitive price is unknown—see paragraph 4.51). Furthermore, as we noted above (see paragraphs 4.34 and 4.35), consumers do not just choose between Sky Movies packages offered by different retailers. Indeed, in our view, a Sky Movies package offered by one traditional pay-TV retailer was unlikely to be the closest substitute for a Sky Movies package offered by another traditional pay-TV retailer—rather, the closest substitute was more likely to be another package offered by the same traditional pay-TV retailer. Responses to our December 2010 survey indicated that, if respondents' current pay-TV retailer stopped offering Sky Movies, only 12 per cent of Sky Movies subscribers would switch to another pay-TV retailer with Sky Movies, while 65 per cent would remain with their current pay-TV retailer.[43]

4.57 Additionally, we noted that defining the market as Sky Movies packages would mean including some products in the market when purchased by subscribers who also purchased Sky Movies channels, but excluding them when purchased by subscribers who did not purchase Sky Movies packs. As we noted in relation to Sky Movies products (see paragraph 4.55), the concept of a market is usually based around a product or group of products, implying that when sold by the same company other products (such as basic pay TV and Sky Sports) should either be outside or inside the market and not partially in and partially out.[44]

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[41] See *CC3*, paragraph 2.4.
[42] Price discrimination could be a reason for defining a market to include a product for some customers and not others. While Sky does price discriminate (because the incremental prices of its combined Sky Movies and Sky Sports products are below the total incremental price of their constituent sports and movies products—see paragraph 2.100*(b)*), this is not a valid reason for including in the market Sky Sports packs when purchased by subscribers who also subscribe to Sky Movies. Generally, the lower incremental price of Sky Sports when taken with Sky Movies does not reflect lower willingness to pay for Sky Sports since more subscribers view Sky Movies than Sky Sports as incremental (see Appendix 4.11).
[43] See Appendix 4.10, paragraphs 55 & 56. The remainder of respondents said that they would switch to a pay-TV retailer without Sky Movies, stop subscribing to pay TV or did not know what they would do. As discussed in Section 6, these results may have been affected by the fact that some Sky Movies subscribers do not have a choice of pay-TV retailer offering Sky Movies, but the effect of this was likely to be small (see Appendix 6.3).
[44] As noted above, price discrimination could be a reason for defining a market to include a product for some customers and not others. However: in relation to Sky Sports, we noted above (see footnote to paragraph 4.55) that price discrimination was not a valid reason for including in the market Sky Sports packs only when purchased by subscribers who also subscribe to Sky Movies; and, in relation to basic channels, we noted there is no price discrimination according to whether or not a subscriber takes Sky Movies. That is, the price for basic channels is the same for subscribers to Sky Movies packages as for other

4.58 Overall, we did not believe that we should define a market limited to Sky Movies packages.

Summary of assessment on narrow retail market definition

4.59 We reached our conclusions on whether there should be a narrow market definition limited to Sky Movies packs, products or packages on the basis of *(a)* our assessment of (i) the evidence we gathered as to how the products under consideration are purchased and supplied, and (ii) the ways in which rivalry occurs more generally in the pay-TV sector; and *(b)* our application of the hypothetical monopolist test. Overall, we found that the evidence was consistent.

4.60 We found that, while Sky Movies does not have close substitutes, the nature of traditional pay-TV retail competition is such that, in order to answer the statutory questions with regard to the products we were referred (see Section 1), we needed to assess competition at the retail level within a frame of reference which was wider than just Sky Movies. In other words, we believed that the retail market should include other products which are relevant to competition between traditional pay-TV retailers for subscribers.

Other products and services included in the pay-TV retail market

4.61 Some parties suggested or implied that the market should be widened to include retail substitutes for Sky Movies, such as DVDs and movies shown on FTA TV.[45] In our view, the retail competition which mattered for our inquiry was the competition between pay-TV retailers for subscribers (reflecting the issues put to us by the parties). Therefore, we did not consider it appropriate to widen the retail market in this way.

4.62 Since competition between traditional pay-TV retailers is principally to acquire and retain subscribers, we included in the pay-TV retail market the Sky Movies products (which were the focus of our inquiry), and other pay-TV products relevant to consumers' traditional pay-TV subscription decisions (both whether or not to subscribe and, if so, which traditional pay-TV retailer to subscribe to (see paragraph 4.63)). We then considered which other products and services should be included in the pay-TV retail market (see paragraphs 4.63 to 4.73).

Basic pay-TV products and Sky Sports

4.63 Basic pay-TV products and Sky Sports are included in pay-TV packages with Sky Movies, and are therefore connected in the process of rivalry for subscribers to pay-TV packages. For this reason, we judged that, in addition to Sky Movies, the pay-TV retail market should include at least these products. In our view, not to include these products would result in an assessment which was a poor proxy for the reality of competition.[46]

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subscribers (since the price of each Sky Movies package is the basic package price plus the incremental price of the Sky Movies product, see Table 2.5).

[45] Our detailed consideration of whether these products were close substitutes for Sky Movies is set out in Appendix 4.1.

[46] We discuss below whether we should also have included in the market other pay-TV products such as SVOD and TVOD/ PPV, whether offered as part of traditional pay-TV packages or OTT (see paragraphs 4.65–4.73).

Other products

4.64 Next, we considered whether there were other pay-TV products or services which should be included within the pay-TV retail market. In particular, we considered whether SVOD services and TVOD/PPV services, both of which are generally offered by traditional pay-TV retailers (as well as by others), should be included within the market definition. The principle we sought to apply was to include them if we found these products to be relevant to consumers' traditional pay-TV subscription decisions. We discuss each in turn.

- *SVOD products*

4.65 SVOD products are offered both by traditional pay-TV retailers and by OTT pay-TV retailers.

4.66 The traditional pay-TV retailers often include VOD services as well as linear channels in their pay-TV packs. For example, Sky Movies subscribers on Sky with Sky Anytime+ and on Virgin Media have VOD access to a subset of the movies being shown on the Sky Movies channels.[47] Therefore, Sky Movies is available to most consumers as a hybrid linear/SVOD product. Some traditional pay-TV retailers also offer SVOD-only products. For example, BT Vision offers Vision Film (previously branded Film Club) and Virgin Media offers PictureBox.[48]

4.67 It appeared to us that, in making a decision to subscribe to traditional pay-TV or to continue with a traditional pay-TV subscription with a particular retailer, consumers would consider the SVOD-only products as part of the choice, in the same way as they considered hybrid linear/SVOD products (such as Sky Movies) and indeed linear-only products. For this reason, we included SVOD-only products offered by traditional pay-TV retailers in the retail market definition.

4.68 Turning to OTT products, we noted that Sky Movies on Now TV offers substantially the same content as Sky Movies on traditional pay TV, and that its price is similar to the incremental price of Sky Movies on traditional pay TV (when not bought with Sky Sports). Therefore, it appeared to us that Sky Movies on Now TV was highly relevant to our assessment of competition and we included it in our retail market definition.

4.69 The OTT services offered by LOVEFiLM and Netflix are also SVOD products.[49] On the basis of the evidence we reviewed (see Appendix 4.2), we concluded that the SVOD OTT services of LOVEFiLM and Netflix were closer competitors to each other than to packages of traditional pay-TV (which include movie channels, but also sports channels, general entertainment programming etc).[50] We also noted that there were some significant differences between the OTT services of LOVEFiLM and Netflix and Sky Movies (including Sky Movies on Now TV), such as in relation to price, the number of films and the extent of FSPTW content, and we noted that, in due course, Now TV was expected to offer linear basic pay-TV channels and sports content ([✂]). However, it appeared to us that Sky's launch of Sky Movies as the first content avail-

[47] This has been the case for Sky Movies subscribers on Sky since the launch of Sky Anytime+ in November 2010 and on Virgin Media since summer 2011. Prior to March 2012, Sky Anytime+ was only available to Sky subscribers with Sky broadband.
[48] BT's Vision Film incorporates the content of PictureBox and includes other movie content.
[49] Many subscribers to LOVEFiLM receive a DVD rental by post service as well as VOD but we consider them also as SVOD subscribers.
[50] We noted that there was some evidence to suggest that, over time, the new OTT services would become closer substitutes for packages of traditional pay TV, at least for packages offering general entertainment and movies, although we did not expect them to become close substitutes in the foreseeable future (see Appendix 4.2). We also expected that, on the basis of the evidence available to us and whilst acknowledging that we could not be certain about future events, at least one of LOVEFiLM or Netflix would remain in the market supplying an SVOD OTT service in the longer term (see Appendix 4.2).

able on Now TV was at least in part a response to the perceived competitive threat from LOVEFiLM and Netflix.[51] Moreover, other evidence supported there being some competitive interaction between these services.[52] Overall, we found that there was sufficient rivalry between the OTT services of LOVEFiLM and Netflix and traditional pay TV to include them in the pay-TV retail market.

4.70 Before we move on to discuss further products which may or may not be included in the retail market definition, at this stage of our analysis we had found a retail market definition which included both traditional pay-TV packages and OTT SVOD services, whether offered by traditional pay-TV retailers or OTT pay-TV retailers.

- *TVOD/PPV and à la carte channels*

4.71 We considered whether TVOD/PPV services and à la carte channels should be included in the retail market definition.[53] TVOD/PPV services are offered by traditional pay-TV retailers and OTT pay-TV retailers.

4.72 With regard to traditional pay TV, it was less clear than with SVOD that these services would influence consumers' pay-TV subscription decisions. It was at least possible that consumers made their pay-TV subscription decisions without taking account of the additional options for purchasing TVOD/PPV and à la carte channels made possible through some platforms. If so, TVOD/PPV and à la carte channels would be outside the pay-TV retail market. We saw little evidence relevant to this issue and we did not think it necessary to reach a view on whether these services were within or outside our core pay-TV retail market in order to assess pay-TV retail competition. We noted the number of large retailers now offering transactional services distributed over the open Internet (see paragraph 2.134). We also noted that the widespread provision and increasing adoption of these services might represent an increasing constraint on SVOD services in particular, which could affect competition in the pay-TV retail market (including for packages of traditional pay TV and SVOD services). However, we remained uncertain about the implications of these developments and we had little evidence on the relative take-up of either TVOD/PPV services or à la carte channels.

4.73 Overall, we found that it was not necessary for us to reach a view on whether TVOD/PPV services and à la carte channels were within or outside our pay-TV retail market definition in order to assess competition. In the subsequent sections of this report, we therefore refer to these services as necessary.

Conclusions on pay-TV markets

4.74 Before we move on to discuss further possible products which we considered including in the retail market definition, at this stage of our analysis we had reached a retail market definition which included both traditional pay TV packages and OTT SVOD services, and which may or may not have included TVOD/PPV services.

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[51] We noted that the launch of Sky Movies on Now TV would reduce the minimum price of accessing Sky Movies from £32 to £15 (see Appendix 4.2), which represented a substantial effect.

[52] Though the extent of interaction between traditional pay TV and OTT was uncertain, it did not appear to us to be of a different order of magnitude to that between different traditional pay-TV retailers. The available evidence suggested that about 6 per cent of traditional pay-TV subscribers switched between retailers per year (see paragraph 5.29), while the results of our recent survey (February 2012) suggested that, in 2012, OTT services may impact on around 3 per cent of subscribers to traditional pay TV (see Appendix 4.2).

[53] We use the term 'à la carte channel' to refer to channels sold by a pay-TV retailer separately rather than as part of a pack of channels.

Pay TV or wider market

4.75 Having found that the appropriate retail market definition for our inquiry was at least as wide as pay TV, we considered next whether it was wider still. In particular, we considered whether, in the absence of barriers to competition, the constraints on pay-TV products came from other pay-TV products or from other sorts of product. Again, we considered both evidence on product characteristics and the ways in which rivalry occurred and sought to apply the hypothetical monopolist test, asking the conceptual question of whether a hypothetical monopolist retailer of pay-TV would be able profitably to price above the competitive price by at least a SSNIP.

4.76 As a general observation, we noted that pay-TV products were quite different from other products. Pay-TV products *(a)* require a monthly subscription (for most traditional pay-TV subscribers this is substantial, often more than £200 per year); and *(b)* offer the ability to choose from a large range of content by viewing linear channels and/or on-demand content immediately on TV, as distinct, for example, from DVDs which require upfront payment for the right to view a movie or TV programme and either a shopping trip or a wait for the DVD to be delivered by post. We noted that the latter point was becoming less important over time as more consumers purchased content via EST rather than on physical DVDs (see Section 2) but we judged that, at the time of our report, the distinction between pay-TV products and DVDs/EST remained significant. As a first step in our application of the hypothetical monopolist test, we considered whether a hypothetical pay-TV monopolist could charge higher prices than those charged by existing pay-TV retailers, which involved relaxing the constraint that pay-TV retailers imposed upon each other. However, this was only a first step as, in the presence of barriers to competition, we would have expected the prices charged by existing pay-TV retailers to be above the competitive level (see paragraph 4.51), so some further analysis or reflection on the results was also required.

4.77 We recognized that pay-TV retailers were not identical to each other in that they did not offer exactly the same packages as each other or charge the same price for similar packages, and we accepted that this differentiation limited the strength of the constraint they imposed on each other. Even so, we recognized that such constraints might be sufficiently strong for pay-TV retailing to be a separate market. According to the hypothetical monopolist test, it would be a market if monopolizing pay-TV retailing (and thereby removing the constraints that competing pay-TV retailers currently imposed on each other) would enable the hypothetical monopolist profitably to impose a SSNIP. As Sky was the pay-TV retailer with by far the largest number of existing subscribers, and Virgin Media had most of the remaining pay-TV subscribers,[54] the constraints imposed by Virgin Media on Sky, and vice versa, were key to assessing the extent to which a hypothetical pay-TV monopolist could charge higher prices than those charged by existing pay-TV retailers.

4.78 Econometric analysis based on differences in Sky's penetration across local areas in 2008 provided some evidence on the constraint that Virgin Media imposed on Sky (see Appendix 4.6). In our view, this evidence was consistent with a hypothetical pay-TV retail monopolist being able profitably to increase prices above existing levels by a SSNIP.

4.79 We also reviewed Sky's monitoring of its competitors in the recent past (see Appendix 4.7). In our view, this evidence suggested that other traditional pay-TV

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[54] OTT services are developing rapidly but, at present, we found them to be closer competitors to each other than to traditional pay-TV retailers (see paragraph 4.69). Hence, for the purposes of our inquiry, the constraints imposed by Sky on Virgin Media and vice versa remained the most important within pay-TV retailing as a whole.

retailers (Virgin Media and BT) were Sky's closest competitors, and a more significant constraint on Sky's pay-TV products than non-pay TV companies (eg FTA broadcasters). Again, we took the view that this evidence was consistent with a hypothetical pay-TV monopolist being able profitably to charge higher prices than those charged by existing pay-TV retailers (though it did not enable any quantification).

4.80 In general, these two analyses related to the constraint imposed by other pay-TV retailers on Sky but, because of the asymmetry in existing subscribers, we expected the constraint imposed by Sky on other pay-TV retailers to be at least as strong.

4.81 Given that the hypothetical monopolist test should be carried out at competitive prices (see paragraph 4.51), we considered how the evidence considered above, which related to existing price levels (see paragraphs 4.78 and 4.79), should be interpreted. We noted that to the extent we believed competition between pay-TV retailers to be ineffective (see Section 5), existing average prices were likely already to be above the competitive level. However, this suggested that the prices charged by a hypothetical monopolist would be further in excess of competitive prices than they were of existing prices. Since our assessment was based on existing prices and competition, this increased our confidence that pay TV was not too narrow a market definition.

4.82 In the light of the above, we judged that a hypothetical monopolist retailer of pay-TV would be able profitably to increase prices compared with competitive levels. For this reason, and on the basis of evidence on product characteristics (see paragraph 4.76) and rivalry more generally, we found that the appropriate retail market definition for our inquiry did not need to be widened beyond pay TV.

4.83 Having reached this view, we did not, for market definition purposes, need to consider other products which could be substitutes for pay TV. Nevertheless, in the light of responses we received to our working papers, our August 2011 provisional findings and our May 2012 revised provisional findings, and other submissions, we considered two specific products and the extent to which they affected pay-TV retail competition: communications products and FTA TV.

Communications products

4.84 Communications products comprise broadband, telephone calls and line rental, and all these products are offered by most of the traditional pay-TV retailers (ie Sky, Virgin Media, BT and TalkTalk), as well as by other parties. These four pay-TV retailers offer bundled packages of communications products with packages of pay TV, referred to as 'triple play' packages.[55] For example, Sky offers free 'lite' broadband and evening and weekend telephone calls to UK landlines to all its pay-TV customers (see Table 2.5). We noted that two of the largest suppliers of telecommunications services (BT and TalkTalk) had started to supply pay-TV services relatively recently and, to date, had obtained only a small share of pay-TV subscribers (see Table 2.4 and Section 5).

4.85 In September 2011, about [✂] per cent of Sky's pay-TV subscribers took a communications product from Sky (this included subscribers taking up the offer of free 'lite' broadband and those taking other communications products). We noted that the percentage was [✂] for Virgin Media[56] and that Sky's percentage increased during

[55] They are referred to as 'triple-play' packages because they include pay-TV, broadband Internet and telephony products.
[56] At this time, the percentage of Virgin Media pay-TV subscribers taking broadband and/or line rental was [✂] per cent.

the course of our inquiry and was likely to increase further (we noted that the percentage was considerably higher for new subscribers).

4.86 Other evidence we saw also suggested significant linkages between competition in communications products and competition in pay TV.[57]

4.87 We considered whether our reasoning concerning a wide pay-TV retail market (see paragraph 4.60) implied that bundling of pay-TV and communications products justified a wider market comprising both these retail products. However, we noted that the percentage of pay-TV subscribers taking a communications product remained much lower than the percentage of Sky Movies subscribers taking other pay-TV products (which was all Sky Movies subscribers except those subscribing on Now TV).[58]

4.88 Overall, we judged that the pay-TV retail market was separate from a market for communications products. Nevertheless, we recognized that features of one market could affect another and features of the pay-TV market may have effects in related communications markets, and vice versa. Moreover, we recognized that interactions were likely to increase if competition continued to be increasingly focused on 'triple-play' packages. We believed that it was appropriate to take account of communications products as an 'out-of-market constraint', ie a factor which is outside the market but which we nevertheless take into account in our assessment of competition. We considered the effects of these products as necessary in our analysis of pay-TV retail competition (see Section 5).

FTA TV

4.89 In considering FTA TV, we noted that there was a distinction between, on the one hand, competition between broadcasters for viewers and advertisers and, on the other hand, competition between pay-TV retailers for subscribers. Sky is both a broadcaster and a pay-TV retailer and so is involved in both types of competition. Consequently, Sky competes with other broadcasters (including FTA broadcasters) for viewers and advertisers, as well as competing with other pay-TV retailers for subscribers.

4.90 We considered how FTA broadcasting affected competition for pay TV, noting the following points:

(a) Since consumers' willingness to subscribe to pay TV is likely to depend to a significant extent on the attractiveness of pay-TV channels relative to FTA programming, FTA broadcasting may exercise an overall constraint on the charges of pay-TV retailers. In principle at least, this constraint might be very strong and, if so, there would be minimal distinction between competition between broadcasters for viewers and advertisers and competition between pay-TV retailers for subscribers. However, we noted that subscribers to pay TV were prepared to pay significant sums to view pay-TV programming in addition to FTA services (see paragraph 4.76), which suggested that subscribers perceived a distinction in the services offered by pay TV and FTA TV. We also noted that the focus of pay-TV retailers was different from that of FTA broadcasters, as expressed, for example, by the Chief Operating Officer of Sky who has said that, for a pay-TV company, it was 'much, much more fundamental' to get subscribers than viewers.[59] For these

[57] [✂]
[58] [✂]
[59] Speech to the Broadcasting Press Guild: www.guardian.co.uk/media/2011/feb/03/sky-atlantic-virgin-media.

reasons, we did not believe the constraint from FTA TV to be so strong that there was minimal distinction between competition between broadcasters for viewers and advertisers and competition between pay-TV retailers for subscribers. On the contrary, we found that the primary constraint on pay-TV retailers was the competition for subscribers from other pay-TV retailers.

(b) In order to encourage viewing of FTA channels, FTA broadcasters have formed or participated in consortia to promote the take-up of platforms which are predominantly or exclusively devoted to FTA channels, ie Freesat and Freeview. Freesat has promoted the sale of equipment that enables viewing of FTA channels on satellite without a pay-TV subscription, and Freeview[60] has promoted the use of DTT. In this way, Freesat and Freeview, together with the retailers of the relevant STBs, could be seen as having competed with traditional pay-TV retailers for consumers to use their platforms. Indeed, from Sky's internal documents, it appeared to us that the development of Freeview in the early to mid-2000s affected Sky's subscriber growth and caused Sky to respond by altering its packaging and marketing (see Appendix 4.7). However, Sky's recent business documents suggested that Freeview may be less of a constraint on Sky than previously. A new consortium (YouView) recently began to promote its STBs with an Internet connection, offering seven-day catch-up of FTA programmes via scrolling back through the EPG (see Section 2).[61] However, while YouView may facilitate FTA viewing, it may also facilitate pay TV. We noted that two traditional pay-TV retailers (BT and TalkTalk) were part of the YouView consortium and would soon offer pay TV through YouView STBs. Overall, it seemed to us that there was likely to be a mix of opportunities and threats for the traditional pay-TV retailers from YouView. Similarly, it seemed to us that YouView was likely to give rise to a mix of opportunities and threats for OTT retailers. We noted that [✂]. We noted also that Sky had announced its intention to offer Now TV on YouView. YouView told us that its primary target audience was the Freeview base, specifically Freeview homes with a broadband Internet connection; its secondary target audience was Sky and Virgin Media homes looking for a second set; and its tertiary target audience was newcomers to broadband and even digital TV (though YouView noted that this audience was likely to be within the core Freeview base).

4.91 Although, for the reasons set out above, we found that there was a retail market for pay TV (see paragraph 4.82), we noted the evidence suggested that FTA TV imposed some constraint on pay-TV retailers, including Sky. In particular, [✂], and the 2008 econometric evidence submitted to us by Sky (see Appendix 4.7) supported this conclusion. We believed that it was appropriate to take account of FTA TV as an 'out-of-market constraint',[62] reflecting that consumers have different preferences for FTA TV and pay TV but that there are some pay-TV subscribers for whom the next best alternative is FTA TV, eg due to the fact that the principal competitor, Virgin Media, covers only about half of the country (though we noted that the number of such consumers was likely to be lower following the emergence of OTT pay-TV services). It also possibly reflected an absence of effective competition in pay-TV retailing (see Section 5) as, if prices were above the competitive level, more pay-TV subscribers would be likely to regard FTA TV as their next best alternative than would otherwise be the case. On this basis, we took constraints from FTA TV into

[60] Sky (which is a broadcaster of FTA as well as pay-TV channels) is a member of the Freeview consortium.
[61] See www.youview.com/get-youview/.
[62] We have set out above (see paragraphs 4.68 & 4.69) the reasons for including OTT SVOD products in the pay-TV retail market. These include that OTT SVOD products are relevant to competition between subscribers and that one of the OTT SVOD products (Sky Movies on Now TV) offers substantially the same content as Sky Movies on traditional pay TV. These services therefore appeared to us to be highly relevant to our assessment of competition.

account as appropriate in our analysis: in particular, in our analysis of switching between pay-TV retailers (see paragraph 5.32), the possibility of Freesat assisting entry into pay-TV retailing (see paragraph 5.67) and innovation (see paragraph 5.79).

Conclusions on pay TV or a wider market

4.92 For the reasons set out above, we found that the retail market definition was pay TV, including both traditional pay-TV packages and OTT SVOD services. We found that it may or may not include TVOD/PPV services and à la carte channels (see paragraph 4.73). We did not include either communications products or FTA TV in the retail market definition but we considered their effects as necessary in our analysis, recognizing that they were 'out of market' constraints.

Treatment of pay TV and FTA TV in Ofcom's Pay TV Statement and in previous competition inquiries

4.93 In this subsection, we discuss market definition in Ofcom's Pay TV Statement and in some previous competition inquiries which were brought to our attention by parties.

4.94 In its Pay TV Statement Ofcom said that the starting point for its retail market definition analysis (ie the focal product) was Sky's premium movie channels, effectively the content included in Sky Movies packs.[63] Ofcom assessed the constraint imposed by all substitutes on the supply of the focal product and concluded that, even when taken in aggregate, they did not constrain Sky Movies to the competitive price.[64] We explained above the reasoning for our finding that the market should be wider than the Sky Movies packs, ie wider than Ofcom's focal product (see paragraphs 4.33 to 4.54).

4.95 In its 2002 decision under the Competition Act 1998 (CA 1998),[65] the OFT found that the relevant markets were no wider than the retail (and wholesale) supply of premium film channels, characterized by first-run Category A and Category B films[66] shown within the pay-TV window. However, the main issue considered by the OFT in its decision was whether the margin between Sky's wholesale and retail terms was sufficient to enable a reasonably efficient pay-TV retailer to earn a normal profit on the supply of premium sports and movie channels. As Sky retailed its premium sports and films channels within bundles which included other pay-TV services, the OFT's analysis of Sky's margin was focused on the profitability of its pay-TV retailing as a whole, rather than on the profitability of Sky's retailing of sports and movie channels. Hence, it seemed to us that the OFT's overall frame of reference for the analysis of the central issue to its investigation was the wider pay-TV retail market, which we also identified, and not the narrower movies and sports markets that the OFT found. The OFT's definition of narrower markets also did not seem to determine its findings

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[63] Ofcom Pay TV Statement, paragraph 6.26.
[64] Ofcom Pay TV Statement, paragraph 6.254. Ofcom also said in this paragraph that the evidence it had considered overall led it to conclude that the relevant market at the retail level comprised retail bundles including Sky Movies. It appeared to us that this latter definition (retail bundles including Sky Movies) was wider than Ofcom's focal product (Sky's premium movie channels, ie the content included in Sky Movies packs) as it included some Sky Sports packs, basic channels and communications products.
[65] BSkyB investigation: alleged infringement of the Chapter II prohibition, 17 December 2002: www.oft.gov.uk/shared_oft/ca98_public_register/decisions/bskybfinal1.pdf.
[66] Category A and B films were defined as:
- 'Category A: US box office receipts exceeding $… and/or UK box office receipts exceeding £... and/or UK video rentals exceeding ...m transactions.'
- 'Category B: US box office $...–$... and/or UK box office £...–£... and/or UK video rentals ...–... transactions. Also includes movies acquired as ... and ....'

on the other two issues it considered.[67] We also noted that the OFT's decision was made almost ten years ago, since which time there had been many changes in the market,[68] and we had a different task from that which the OFT had under CA 1998. In these circumstances, and for the reasons outlined, we did not believe that we should be constrained by the OFT's earlier views.

4.96 Sky pointed out that, in the CC's assessment of its acquisition of a 17.9 per cent stake in ITV, the CC defined the market as all TV rather than just pay TV, stating that FTA TV was a constraint on Sky's pay-TV prices.[69] However, markets are not unique[70] and, in our view, the existence of a pay-TV market was consistent with there also being a wider all-TV market including FTA broadcasting (as long as FTA broadcasting was a constraint on pay TV). Moreover, as stated in our merger guidelines, the relevant product market may potentially be wider than the narrowest market that satisfies the hypothetical monopolist test.[71] It may be appropriate to define the relevant market as pay TV when the issues concerned arise in pay TV and to define a wider all-TV market to assess an issue arising from a merger between a pay-TV retailer and broadcaster and an FTA TV broadcaster.[72] Indeed, the CC's report into Sky's acquisition of a 17.9 per cent stake in ITV specifically stated that, while the all-TV market was relevant to assessing the effect of the acquisition, it was not necessarily relevant in other circumstances.[73]

4.97 Associated with this point, we noted that in considering Sky's acquisition of a 17.9 per cent stake in ITV, the CC did not need to consider whether competition in pay-TV retailing was effective, and hence whether the market definition might be affected by whether existing prices of pay-TV retailers were above the competitive level. As noted above, this was a point we did need to consider in this inquiry (see paragraph 4.81).

4.98 Sky also pointed to a statement in the CC's report on the merger of Carlton and Granada in 2003 that 'the launch of Freeview has, by introducing non-terrestrial channels which are free-to-air, further blurred the distinction between pay-TV and terrestrial channels, to the extent that they can be seen as differentiated products within the same market'.[74] However, the merger of Carlton and Granada was a merger of two ITV broadcasters and the CC was concerned with competition between broadcasters for viewers and advertising.[75] The CC was not concerned in that inquiry with the constraint that FTA broadcasting exerted on the subscriptions charged by pay-TV retailers. We noted that our inquiry was concerned with current competitive

[67] The OFT's 2002 decision also considered two other aspects of Sky's wholesale pricing: its practice of offering a large pack of channels at a lower price than the total price of a group of smaller packs (known as mixed bundling); and its practice at the time of offering discounts to retailers which achieved targets for penetration of Sky Movies and Sky Sports channels.
[68] See Appendix 8.1, paragraph 51*(a)*.
[69] *BSkyB/ITV: acquisition by British Sky Broadcasting Group Plc of 17.9 per cent of the shares in ITV plc,* published by the Secretary of State for Business, Enterprise and Regulatory Reform, 20 December 2007.
[70] We made the same point about markets not being unique in our 2009 report on BAA airports (see paragraph 2.45 of that report). In that report, the point was that the existence of separate Edinburgh and Glasgow airport markets did not alter the fact that there was a wider market including both these airports which was the relevant market for assessing BAA's common ownership of both airports. Further, we undertook a review of previous competition decisions in the TV sector and found that other regulatory bodies had found pay TV to be a separate market from FTA TVad(see paragraph 4.99).
[71] *Merger Assessment Guidelines, CC2 (Revised)*, a joint publication of the CC and the OFT, September 2010, paragraphs 5.2.3 & 5.2.8.
[72] For similar reasons, we did not see any inconsistency between the 2007 report and earlier CC reports (such as that in March 2000 considering a merger of two cable suppliers) which found pay TV to be a separate market.
[73] Paragraph 4.31 of the CC report stated 'the relatively broad market that we defined in paragraph 4.30 is the appropriate framework for analysing any loss of competition arising from this acquisition. However, we note that this does not imply that the same market definition should necessarily be used to analyse other mergers in the industry or should necessarily apply in other competition cases'.
[74] CC report, *Carlton Communications Plc/Granada Plc: a report on the proposed merger*, 2003, paragraph 5.33.
[75] The report summary states (paragraph 1.7) 'our major focus was on the effect of the proposed merger on the sale of Carlton's and Granada's airtime: we concluded that the relevant economic market for this purpose was television advertising as a whole'.

conditions rather than the position in 2003 and, as noted in paragraph 4.90*(b)* the significance of Freeview as a constraint on Sky appeared to have reduced since that time.

4.99 We noted that many previous competition decisions had found pay TV to be a separate market from FTA TV, including some European Commission decisions. For example, in its consideration of News Corporation's acquisition of Premiere, the European Commission referred to its consistent practice of considering the distribution of pay TV as a separate product market from FTA TV.[76] When considering a merger of two pay-TV retailers, rather than mergers where at least one merging party was an FTA broadcaster rather than a pay-TV retailer, the CC too has found pay TV to be a market separate from that of FTA TV (while acknowledging interactions between pay TV and FTA TV).[77]

4.100 In summary, some previous competition inquiries have defined a narrower retail market than pay TV (eg premium movies) but, for the reasons set out above, we rejected that approach in this case. A review of merger cases showed that whether to expand the market definition to include all TV depended on the context of the investigation and the relevant statutory questions but, in our view, there was nothing in these cases to suggest that we should define a wider market than pay-TV retailing in this case.

Views of parties on retail market definition

4.101 BT, Virgin Media, Sky and other parties provided extensive comments on our analysis of retail market definition, which we considered carefully.[78] In this section, we set out briefly the key points raised by parties which have not been dealt with elsewhere and summarize our views on them.

Whether there is a narrow retail market for FSPTW movie services/Sky Movies

4.102 BT agreed with our view that pay-TV suppliers competed in a market that did not extend to FTA TV or other ways of consuming movies (eg DVDs), but said that we should also have considered a narrower retail product market for FSPTW movie services. BT said that, in defining only a broad retail market for pay TV, we had not properly considered the specific impact of FSPTW movies at the retail level. In its comments on our working paper, BT said that, by way of an analogy with supermarkets, we had essentially considered Tesco and Sainsbury's and the factors on which they competed in aggregate as supermarkets, but had neglected the specific impact in respect of, for example, the narrower market for the retailing of milk and the extent to which any competitive restrictions existed in this narrower market. We did not agree as, in our view, the inference to be drawn from BT's analogy was the opposite of that suggested by BT. Retail competition between supermarkets is across all groceries,[79] and the effect on competition of a specific issue, such as 'loss leading' in milk, would need to be considered within a broad retail market. In that context, 'loss leading' on a particular product would not generally be a concern unless it damaged retail competition and, in order to assess whether retail competition was damaged, it would be necessary to consider the market in which that competition occurs. However, we agreed with BT that, if the concern was with any upstream effects of 'loss

[76] Case No COMP/M.5121.
[77] NTL Incorporated and Cable & Wireless Communications Plc: a report on the proposed acquisition, March 2000.
[78] These comments were on our market definition working paper, our August 2011 provisional findings, our market developments working paper and/or our May 2012 revised provisional findings. Our assessment of market definition was similar in all these documents.
[79] See CC report, *The supply of groceries in the UK market investigation*, 30 April 2008.

leading', eg on the upstream suppliers, it was necessary to consider a narrower market for that particular product. In our view, this paralleled the approach we had taken as we had adopted a broad retail market definition and a narrow upstream market definition (see paragraphs 4.143 to 4.169).

4.103 In its comments on our May 2012 revised provisional findings, BT said that we had ignored established economic practice in our market definition assessment. BT said that the purpose of a market definition exercise was to identify whether two products were sufficiently close substitutes so as to exercise a pricing constraint upon each other and hence form part of the same relevant market. In BT's view, in this case establishing the boundary of the relevant market was critical in identifying the relevant competitive constraints in the market under investigation.[80] BT said we had recognized that Sky Movies 'can be considered as a single product' and on the basis of empirical analysis concluded that this product did 'not have close substitutes'. BT said that, therefore, we had identified a retail product which did not have close substitutes. In BT's view, this in itself ought to have been sufficient to conclude that a narrow retail product market existed. However, we did not agree with BT's view. The purpose of market definition is to provide a framework for the assessment of the effects on competition of features of a market. Moreover, the market definition process is not simply concerned with identifying whether just two products are sufficiently close substitutes to exercise a pricing constraint upon each other, but with identifying a product or group of products which are not subject to competitive constraints or, more generally, with identifying a product or group of products which are connected by a process of competition. Where individual products are differentiated, it is quite likely that a particular product, such as Sky Movies, does not have any single close substitute but, nevertheless, it does not in itself constitute a separate market as it has many substitutes which together constrain its price. As we discuss above (see paragraph 4.51), the current price of Sky Movies might be above the competitive price but a market definition which simply assumed this would not have provided a suitable framework for our analysis (because we needed to establish whether the price of Sky Movies was above the competitive level, rather than just assume it).

4.104 In its comments on our revised provisional findings, BT made some further points:

(a) BT said that the existence of bundling did not mean that competition issues which related directly to individual retail products should be considered only within the context of the broader bundle. However, as we have set out above, competition between traditional pay-TV retailers occurs across different products and competition is not limited to pay-TV products that include Sky Movies. Further we found that the competition issues identified to us and which were captured in our theory of harm could not be addressed by reference to Sky Movies alone. We did not identify any other issues which might have suggested a narrower frame of reference was required, and BT did not put forward any alternative theory of harm.

(b) BT said that we had referred to Sky Movies on Now TV as an unbundled product, but this development equally showed that products containing FSPTW movie content (including Sky Movies) could be disaggregated into separate stand-alone products from a wider pay-TV bundle. In BT's view, we had used as evidence the fact that Sky Movies could be disaggregated to support our views with respect to market developments, while at the same time we had not taken such evidence

[80] While BT agreed that market definition was not an end in itself, but rather a framework within which to analyse the effects of market features, BT considered that in this case it was particularly important given the investigation was focused on assessing the extent to which FSPTW movie products/services were necessary for competitors to be able to compete within the relevant market once it had been identified.

into account when determining whether Sky Movies could be considered to be a separate and distinct retail product. However, we did recognize in our analysis that Sky Movies is a retail product and on that basis we considered whether Sky Movies by itself (ie Sky Movies packs) constituted the relevant market (see paragraphs 4.39 to 4.54). In our view, the relevance of Sky Movies on Now TV as a new development was that Sky had for the first time made Sky Movies available on an unbundled basis for a price similar to the incremental price Sky charges to its satellite subscribers.

(c) BT said that, after we had concluded that a hypothetical retail monopolist would not be able profitably to impose a SSNIP, at no point in our analysis did we carry out the next part of this assessment, ie to identify the closest substitutes, add them to the product group and repeat the procedure; instead we had simply found that a broad market existed. In BT's view, we had failed to follow our own guidelines in arriving at our market definition, selectively and inconsistently applying the hypothetical monopolist test in our assessment, and concluding that a broad retail pay-TV market containing all pay-TV packages existed with no evidence to support this conclusion. However, in our view, market definition is not an end in itself, and it should be carried out flexibly and in a way that is relevant to the issues under consideration—our guidelines state that we adopt the methodology that is most appropriate in the context of the investigation.[81] In other words, we believe it is important to assess competition problems on an empirical, rather than overly theoretical, basis. For these reasons, we did not accept that the hypothetical monopolist test should necessarily be carried out in the rigid way envisaged by BT. Instead, we believed that we needed to consider the issues raised within the context of actual competition between pay-TV retailers, ie within the broad retail market we had identified (as set out in paragraphs 4.32 to 4.83).

(d) BT said that we had been inconsistent in on the one hand, stating in Appendix 4.1, that movies on basic pay-TV channels were not, among other things, a close demand-side substitute for Sky Movies, and, on the other hand, subsequently including basic pay-TV channels in our market definition. In BT's view, either basic channels and packages of basic channels were a demand-side substitute for Sky Movies or they were not. BT said that, as we had found that they were not a demand-side substitute, they could not then form part of the relevant retail market for the purposes of the CC's investigation. We did not agree, for the following reasons: (i) movies on basic pay-TV channels are a demand-side substitute for Sky Movies, albeit not a *close* one (see Appendix 4.1); (ii) market definition can reflect supply-side as well as demand-side substitutes;[82] and (iii) packages not including Sky Movies (ie basic-pay packages with or without Sky Sports) are most likely to be the closest substitutes for similar packages which include Sky Movies (see paragraphs 4.56 and 4.63).

4.105 Virgin Media said that we should not assess retail competition within a frame of reference as wide as all pay-TV products. It said that the relevant retail market comprised just retail packages including Sky Movies. We disagreed as, in our view, we needed to assess issues connected with the supply of Sky Movies within a frame of reference which took into account the actual competition between pay-TV suppliers, which included other pay-TV products relevant to consumers' pay-TV subscription decisions (see paragraph 4.60).

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[81] *CC3*, paragraph 2.2.
[82] *CC3*, paragraph 2.3, states that both demand-side and supply-side substitution are considered and our new draft market guidelines state (paragraph 134) that the CC may in some cases include supply-side factors in defining the market.

4.106 In its responses to our August 2011 provisional findings and our revised provisional findings, Virgin Media said that rivals offering a pay-TV package which excluded premium movies were at a significant competitive disadvantage compared with a vertically integrated rival which had monopoly control over FSPTW movie content (and this was the case even in circumstances where some consumers may value Sky Movies less highly than other elements of their package). Virgin Media said that, in these circumstances, rival pay-TV retailers could only compete effectively with Sky if they offered packages which contained Sky Movies and, for this reason, the correct retail market definition was retail pay-TV packages which included Sky Movies. However, in our view, this argument was circular in that it assumed the outcome of the analysis we were undertaking. We also believed that our market definition enabled us to establish whether Sky's rivals were potentially disadvantaged due to Sky's position with respect to FSPTW content.

Whether the OTT services of LOVEFiLM and Netflix should be included in the pay-TV retail market

4.107 The major studios told us that the OTT services of LOVEFiLM and Netflix were substitutes for Sky Movies and for traditional pay TV. For example, Warner said it considered that the LOVEFiLM and Netflix services were substitutes for the current Sky Movies service; and Sony Pictures said that it was evident that these new products presented a direct alternative to the current bundled model of subscription pay-TV.

4.108 By contrast, BT and Virgin Media said that the OTT services of Netflix and LOVEFiLM were not substitutes for traditional pay-TV services and/or for Sky Movies. Virgin Media said that these new entrants were competing in a different market segment with propositions which were significantly differentiated from that of Sky (especially in terms of content, price and distribution). BT said that [✂], and based on product characteristics alone, it seemed highly unlikely that the offerings of Netflix and LOVEFiLM would be a substitute for traditional pay-TV services. In BT's view, this was further evidenced by the fact that none of the traditional pay-TV operators had responded to the entry of Netflix or LOVEFiLM in a way that was consistent with these new services being perceived as competitors.

4.109 In its comments on our revised provisional findings, BT reiterated its view that Netflix and LOVEFiLM were not within the wide pay-TV retail market we had defined. In BT's view, the key issue was whether or not Netflix and LOVEFiLM were a relevant constraint on the products we had already identified as forming part of the relevant retail market, ie whether or not they were a sufficiently close substitute for the retail offerings of traditional pay-TV providers. Thus, in BT's view, whether Netflix and LOVEFiLM formed part of the broad retail pay-TV market was an empirical matter. BT considered it noteworthy that all the empirical evidence put forward in our revised provisional findings implied that Netflix and LOVEFiLM were a complement to, and not a substitute for, the retail offerings of traditional pay-TV providers. BT also said that we could have asked ourselves whether, if the price of traditional pay-TV services increased by 5 to 10 per cent, a sufficient number of subscribers would be willing to switch away to take the OTT services of Netflix and LOVEFiLM instead. BT considered that it seemed somewhat implausible that in the face of a 5 per cent price increase a sufficient number of traditional pay-TV subscribers would drop their basic/sports/Sky Movies packages and switch to the OTT services of Netflix or LOVEFiLM to render such a price increase unprofitable.

4.110 In our view, the OTT services of LOVEFiLM and Netflix were likely to be substitutes for some existing and prospective Sky Movies subscribers (as shown in the results of our February 2012 survey), but not for a sufficiently large proportion as to render either service a close substitute for Sky Movies (see paragraph 4.45). Nevertheless, although we found that Sky Movies did not have close substitutes, we believed that the nature of traditional pay-TV retail competition was such that we should assess competition within a frame of reference that was wider than just Sky Movies. Having widened the market to include other pay-TV products relevant to competition for subscribers between traditional pay-TV retailers, we then considered whether other products should also be included in the pay-TV market, for example SVOD products which are offered both by traditional pay-TV retailers and by LOVEFiLM and Netflix. We included both these types of SVOD products within our definition of the retail market as in our view they affected competition for pay-TV retail subscribers (see paragraphs 4.65 to 4.69). Our inclusion of LOVEFiLM and Netflix in the market was consistent with how we treated the SVOD products offered by traditional pay-TV retailers.

4.111 Further, we did not agree with BT that none of the traditional pay-TV retailers had responded to the entry of Netflix or LOVEFiLM in a way that was consistent with the new services being perceived as competitors. In our view, Sky's launch of Sky Movies as an unbundled product on Now TV before other content is made available on this service was at least in part a response to the competitive threat from LOVEFiLM and Netflix. In our view, there was sufficient rivalry between the OTT services of LOVEFiLM and Netflix and traditional pay TV to include these services in the retail market definition (see paragraph 4.69).

4.112 We agreed with BT that, at the time of this report, the extent of substitutability between traditional pay-TV operators' offerings and LOVEFiLM/Netflix was such that it was unlikely that a 5 per cent increase in the price of the former would lead to a sufficient number of traditional pay-TV subscribers switching to the latter. We also acknowledged that, because the OTT services of LOVEFiLM and Netflix were new, there was limited evidence available regarding how far they constrained some or all of the elements of traditional pay-TV packages. However, although smaller suppliers typically exercise a limited constraint on larger suppliers, this does not mean that smaller suppliers should be excluded from the market where they are one among a number of relevant constraints (see paragraph 4.149 in relation to movie rights), and a similar argument applies to new products with similar characteristics to existing products in a differentiated product market.[83] At the time of launch, a new product is unlikely by itself to constrain the prices of existing products but this in itself does not mean that it should be excluded from the market.

4.113 Moreover, even if, as suggested by BT, the boundary of the pay-TV market had been drawn such that the OTT services of LOVEFiLM and Netflix were outside, rather than inside, this would not, in our view, have altered the fact that these services are substitutes to Sky Movies for some customers, and it was only to that extent that we relied upon these services in our assessment of the significance of FSPTW content (and Sky Movies) to subscribers' choice of pay-TV retailer (see Section 6). Hence, we did not believe that adopting this aspect of BT's proposed market definition would have affected the substance of our assessment.

Whether the market should be broader than pay TV

4.114 Sky said that the market was broader than just pay TV. It said that the market included all TV (including FTA TV, TVOD/PPV, SVOD services and free VOD services), and DVD sale and rental. Sky set out its own approach to market definition and told us that the UK audiovisual sector delivered positive outcomes for consumers

[83] We also considered the OTT services of LOVEFiLM and Netflix to be closer substitutes for Sky Movies than the SVOD movie services previously available, such as Vision Film and PictureBox, which we included in the retail market definition.

which were incompatible with hypotheses of either *(a)* narrow markets in which companies exercised significant market power, or *(b)* competition being ineffective more generally. In terms of market definition, Sky considered that such positive outcomes would be unlikely to be observed if the market were the highly-concentrated ‘pay-TV’ market we had defined. In Sky’s view, outcomes were far more consistent with a candidate market which included at least FTA TV. While we accepted that market definition and the assessment of competition are related issues,[84] we did not accept that market definition should rely just on a judgement about competitive outcomes, as appeared to be implied by Sky’s approach. This would ignore the conceptual distinction between rivalry and competitive outcomes as, in principle at least, it may be possible for an uncompetitive market to deliver positive outcomes and vice versa. We discuss outcomes in the pay-TV market in Section 5.

4.115 Sky also said that product characteristics did not need to be identical for products to be potentially substitutable from the point of view of consumers, or to be considered to be supplied in the same relevant market. Sky added that competition could be via differentiation (which could include the use of different business models as well as offering different products to consumers). Sky said that such competition could be intense, often more intense than arises from competition based on imitation of other companies’ products and strategies, and that this was the case in the audiovisual sector. We agreed that product characteristics did not need to be identical for the relevant products to be potentially substitutable, and that product differentiation could be an element of competition. We also agreed that product differentiation was one element of competition in pay TV, among other important elements such as price and quality of service (see Section 5), though we noted that, in pay TV, product differentiation arose as a result of technological differences as well as from companies introducing new products. It appeared to us that Sky regarded the difference between pay TV and FTA TV as a form of product differentiation, but, in our view, pay TV was not too narrow to be a market according to the standard set out in our guidelines (see paragraphs 4.75 to 4.83). Furthermore, although we did not believe that markets should be defined just on the basis of product characteristics, the differences between pay TV and FTA TV seemed to us to be significant, with a key point of difference being that subscribing to pay TV requires payment of a monthly fee (see paragraph 4.90*(a)*).

4.116 With regard to our use of the hypothetical monopolist test to define the boundaries of relevant markets, Sky said that we had failed to have regard to the approach to market definition and market analysis advocated in our newly-revised merger guidelines. Sky said that our approach was entirely misplaced and incongruous with modern mainstream thinking. Sky said that the circumstances of this case (ie a non-merger inquiry in which products are highly differentiated) made its use even more inappropriate. However, in our view, while the hypothetical monopolist test is hard to apply rigorously, it is a useful tool to identify relevant constraints on market power; and our revised merger guidelines continue to support the hypothetical monopolist test for market definition,[85] in particular as a tool to check that the relevant product market is not defined too narrowly. Furthermore, in a market inquiry, market definition provides a frame of reference for the analysis of competition; whereas in a merger inquiry, a frame of reference is provided by the existing competition between the merging companies.[86]

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[84] *CC3,* paragraph 1.21.
[85] *CC2,* paragraphs 5.2.1, 5.2.3, 5.2.8 & 5.2.9–5.2.16.
[86] However, as set out in our merger guidelines, market definition may nevertheless be useful as a tool in assessing competition between the merging companies.

4.117 Sky also said that some of our statements in our August 2011 provisional findings appeared to suggest that the appropriateness of various candidate market definitions had been assessed via the lens of their 'fit' with our theory of harm and/or the necessity of defining a particular relevant market in order to assess our theory of harm. In Sky's view, this approach was incongruous with our explicit concern about the danger of adopting an approach that was close to assuming what we were setting out to test (in relation to wholesale market definition). We did not agree. We believed that our approach to market definition was coherent and consistent. Through the course of our inquiry, we reflected on the implications of our analysis of competition for market definition, as we believed to be entirely appropriate. Market definition is a useful tool rather than an end in itself and we believed that the pay-TV retail market was an appropriate frame of reference for assessing retail competition for the purposes of our inquiry (ie to answer the statutory questions before us), and we found that it was a relevant economic market. In contrast, we found that the wholesale supply of Sky Movies was not an appropriate frame of reference for assessing the issues set out in our theory of harm, though we recognized that if our theory of harm was valid, an implication would be that the wholesale supply of Sky Movies must pass the hypothetical monopolist test.

Finding on retail market

4.118 Market definition is intended to provide a framework for the analysis of competitive effects. In our view, for the purposes of our inquiry, the correct frame of reference for our analysis of retail competition needed to be wider than just Sky Movies[87] because consumers' subscription decisions are affected by other elements of pay-TV packages (including at least basic pay-TV and sports pay-TV products), and competition for subscribers is across all these elements. We also included SVOD services in the pay-TV retail market (for the reasons set out in paragraphs 4.65 to 4.69).

4.119 We believed that pay-TV retailers imposed a sufficiently strong constraint on each other for pay-TV retailing to be a separate market, and we focussed our assessment of retail competition on this market. However, we noted that there were links between competition for pay-TV products and competition for communications products (broadband, telephone calls and line rental) and also that FTA TV exercised some constraint on pay TV. Therefore, we took into account 'out of market' constraints as appropriate in our assessment of retail competition (see Section 5).

Wholesale market definition

4.120 The Sky Movies products that Sky supplies to other retailers on a wholesale basis are the same as the Sky Movies packs which Sky retails to its own customers (see paragraph 4.39*(a)*), except that the wholesale products do not include the Disney Cinemagic channel (which other retailers can obtain directly from Disney).[88] In this subsection, we discuss whether there is a wholesale market for Sky Movies.

4.121 We noted that the wholesale market could be approached in two ways:

(a) It could relate to the actual wholesale supply of Sky Movies by Sky to Virgin Media and other retailers. This was referred to in our terms of reference but it represents a small part of the overall sale of Sky Movies (see Table 2.4).

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[87] Whether Sky Movies packs, products or packages.
[88] Certain cable retailers take a smaller range of channels at a lower price as, due to limited platform capacity, they are able to transmit fewer channels.

(b) It could be expanded to include also a notional wholesale supply of Sky Movies from Sky (as a notional wholesaler) to Sky (as a retailer), ie Sky's self-supply. The total actual and notional wholesale supply of Sky Movies was the wholesale market that Ofcom defined in its Pay TV Statement.

We start by discussing the total wholesale supply of Sky Movies (including both actual and notional supply) and then discuss just the actual wholesale supply.

Total wholesale supply

4.122 In discussing the retail market, we noted that retail competition was for subscribers and covered many pay-TV products, not just Sky Movies. Since the total wholesale demand for Sky Movies is derived from the retail demand,[89] our discussion of a narrow retail market (see paragraphs 4.33 to 4.54) is relevant here. With regard to the retail market, we found that: *(a)* competition between pay-TV retailers was across many pay-TV products and packages and not for single products within a bundled package; *(b)* there were no close substitutes for Sky Movies; *(c)* analysis of substitutability at existing prices was inconclusive because Sky was in effect an actual monopolist of Sky Movies which may already have priced above the competitive price while the hypothetical monopolist test requires a comparison with the competitive price and *(d)* it was unlikely that a hypothetical stand-alone retail monopolist of Sky Movies would be able profitably to impose a SSNIP over the competitive price. For these reasons, we found that it was not appropriate to define a narrow retail market for Sky Movies packs (see paragraph 4.54).

4.123 The total wholesale supply approach was based on the idea that there could be one or more wholesalers selling Sky Movies to retailers (ie wholesaler(s) are vertically separate from retailers). Therefore, we considered whether a stand-alone wholesale monopolist over Sky Movies without Sky's other attributes (ie its pay-TV retailing activity and its Sky Sports and basic channels) would be able to impose a SSNIP over the competitive price. Only if this were the case would it be meaningful to say that Sky had market power arising specifically from its position in this wholesale market. We noted that Sky Movies had exclusive rights to FSPTW content from the six major studios and found that this FSPTW content was important to the appeal of Sky Movies (see paragraph 6.60). Therefore, given also that competition involves more than one supplier, for the purposes of our analysis, we identified the competitive price with the price that would be charged if there were two or more stand-alone wholesale suppliers of movies products with FSPTW content from the major studios.[90]

4.124 In our view, the key factors affecting whether a hypothetical stand-alone wholesale monopolist over Sky Movies would be able profitably to impose a SSNIP over the competitive price were:

(a) The extent to which the offerings of the competing wholesale suppliers were substitutes for each other. This depended on how far retailers could substitute products with other content for FSPTW content from the major studios.[91]

[89] It is the retail demand from final consumers that gives rise to the wholesale demand from retailers. Without the retail demand, there would be no wholesale demand.
[90] A hypothetical competitive scenario may involve suppliers each with exclusive rights from some of the major studios or suppliers with non-exclusive rights from all the major studios or a mixture of the two. In all these cases, we would expect subscribers to have a choice between different sized and priced packages.
[91] It also depended on the extent of complementarity between the two or more competing services. If, in order to obtain the desired variety of content, most consumers wished to subscribe to all or most services, these would be complementary services and weak substitutes and the upward effect on price of a hypothetical monopoly would be smaller than if the two or more competing services were strong substitutes. We discuss the complementarity of content on movie services in Section 7.

(b) The extent, if any, of economies of scope and scale. If economies of scope and scale were limited, we would expect the total cost of two hypothetical suppliers to be not much more than that of one supplier. For example, if Sky Movies' costs were £16 per month per subscriber, the costs of two suppliers each wholesaling half of Sky Movies' content would be about £8 per month per subscriber; however, if economies of scale and scope were significant, the costs would be more than £8 per month per subscriber. Any such cost increases due to a lack of economies of scale and scope would potentially offset, at least to some extent, any upward price effect of a hypothetical monopoly.

(c) The extent of buyer power held by retailers (which have large installed customer bases), and which may be able to obtain rights directly. This could offset any ability of a stand-alone monopoly wholesale supplier to increase prices compared with two or more competing stand-alone wholesale suppliers.

4.125 On these points, our views were:

(a) While having a large proportion of FSPTW content was important to the appeal of Sky Movies, survey evidence suggested that this was less important to consumers than other attributes of a movies service, such as a large range of movies and price (see paragraph 6.80). We noted that other suppliers (such as LOVEFiLM and Netflix) had succeeded in putting together an offer to consumers using FSPTW content from non-major studios, SSPTW, TSPTW and library content from both major and non-major studios and TV programmes, which the available evidence indicated was attractive to many consumers (and we found these services to be a substitute for Sky Movies for some Sky Movies subscribers (see paragraph 4.45)). For this reason, and given that wholesale demand is derived from retail demand, we believed these offerings also represented alternatives to Sky Movies to some extent for retailers. We noted that, in the USA, premium channels, such as HBO and Showtime, did not focus only on FSPTW movie content.[92] Indeed, since 2009, Showtime had not licensed FSPTW rights from any major studio, having stated a preference for investing money in original productions and for buying movies from other sources. Therefore, it appeared to us that retailers could substitute products with other content for Sky Movies and that Sky derived only a limited advantage from being the only supplier with major studio FSPTW content (given also that, compared with some other content, FSPTW movies require higher payments to studios and hence a higher wholesale price).

(b) There are some fixed costs involved in transmitting content to consumers (whether by satellite, cable, IPTV or OTT) and in marketing movie services, but we did not see evidence suggesting that such fixed costs were large relative to content costs.[93] Therefore, in our view, relevant economies of scale and scope were unlikely to be large.

(c) To the extent that we found there to be barriers to parties other than Sky acquiring FSPTW rights, they appeared to derive largely from Sky's position in the retail

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[92] While there are some differences between the UK and the USA (for example, the US market is much larger), the USA was a useful comparator because it has several wholesale premium movie services competing to supply pay-TV retailers. This is not the case in most other countries.

[93] In our provisional findings documents, we noted that other subscription movie services seemed to charge relatively high prices compared with Sky, given their content. For instance, the charge for PictureBox was £5 per month (more than 30 per cent of the incremental retail price for Sky's dual movies product), but this service offered only SSPTW and library movies (though, historically, it offered a small number of FSPTW movies), and only a small fraction of the number of movies on the Sky Movies channels. However, we considered it was difficult to draw conclusions from this evidence concerning the extent of relevant economies of scale and scope.

market (see Section 7). In the hypothetical situation we were considering (a stand-alone wholesaler selling to independent retailers), these barriers would not arise to anything like the same extent. Although the stand-alone wholesale monopolist would be selling indirectly to all customers of Sky Movies, the relationships with customers would be held by the pay-TV retailers/platforms. For this reason, we believed that the pay-TV retailers/platforms would (at least over time) be able to obtain rights directly from the studios to establish their own movies services and hence would constrain the hypothetical wholesale monopolist. Ofcom and some other parties said that the staggering of contract start dates for FSPTW rights represented a barrier because it added to the costs of an entrant which needed FSPTW content from more than one major studio but, in the context of our analysis of a hypothetical stand-alone wholesale monopolist, we thought it was unlikely that the staggered availability of rights represented any significant impediment to entry.[94]

4.126 This assessment suggested that a hypothetical stand-alone wholesaler of Sky Movies would be constrained to some extent by services with content other than FSPTW content from major studios (see point *(a)* above) and by the possibility of others acquiring FSPTW content from major studios (see point *(c)* above). These points suggested that a stand-alone monopolist wholesale supplier of Sky Movies would have no sustainable source of market power as it would have no direct contact with the customers responsible for the demand for its product, and could, over time, be disintermediated by the pay-TV retailers/platforms which did have this contact with customers. For these reasons, we did not believe that there was a separate wholesale market for Sky Movies.

4.127 Notwithstanding this finding, we recognized that a stand-alone monopolist wholesaler of Sky Movies with medium- or long-term studio contracts would, over the term of those contracts, face no constraint from the possibility of others acquiring rights directly (though it would still be constrained by the substitutability of other content), and it may, consequently, have an apparent ability to price above the competitive level during the term of those contracts. However, we would expect retailers to have negotiated similar medium- or long-term contracts with the wholesaler at the time when competitive bidding was taking place, in order to capture the wholesale price at that time, and thus we did not believe that this factor would enable a stand-alone monopolist wholesaler of Sky Movies to impose a SSNIP.

4.128 In addition to its analysis of substitutability, Ofcom referred in its Pay TV Statement to considering evidence on pricing and profitability in reaching its wholesale market definition.[95] We considered this evidence but concluded that we should attach little, if any, weight to it in defining a wholesale market, for the following reasons:

(a) We judged that the high 'premium' price of Sky Movies (compared with the zero price of FTA TV and the low price of basic pay-TV channels) arose because consumers were willing to pay more to have access to a wide range of movies, including FSPTW movies from major studios (and due to the many other attributes of Sky Movies). This willingness to pay would be likely to exist even if there was more than one wholesale supplier. Consequently, we found that nothing about the wholesale market could be inferred from just the apparently high price

[94] We noted in paragraph 7.79 that the risks of large scale entry (ie entry with rights from a number of major studios) might be greater by virtue of the staggered availability of rights. However, in that discussion, the risks of large scale entry were associated with Sky's incumbency position in retailing. The situation is different when considering entry into wholesaling by an incumbent pay-TV retailer or retailers.
[95] Pay TV Statement, paragraph 6.103.

of Sky Movies (for example, as to whether prices would be lower or higher if, hypothetically, there was more than one wholesale supplier of Sky Movies).

(b) As a general matter, we recognized that it may be useful to consider profitability as one among a number of indicators of competitive conditions within a market, but we did not believe that it was appropriate to use profitability to define the market in the first place. In our view, that approach would introduce a circularity, whereby, if a supplier of a differentiated product was earning high profits, the product would constitute a market in which the supplier necessarily had a monopoly. Moreover, as noted in our guidelines, profitability is the key incentive and signal in a market economy and high profits by individual companies at various times can be fully consistent with competitive markets.

4.129 Overall, we did not see a sustainable source of market power arising simply from wholesaling Sky Movies and, therefore, for the purposes of our inquiry, we did not define a total wholesale market comprising both notional and actual wholesale supply of Sky Movies.

Actual wholesale supply

4.130 We then considered Sky's actual wholesale supply of Sky Movies products, which comprised only a small part of the total wholesale supply. The hypothetical monopolist test involves asking whether a hypothetical monopolist would be able profitably to increase prices above the competitive level. However, as Sky was an actual wholesale monopolist over Sky Movies, this test equated to asking whether the competitive price would be below Sky's actual wholesale price by at least a SSNIP. It seemed to us that this question was similar to the question of whether our theory of harm (see paragraph 3.6) was valid. If our theory of harm, including circumstance *(d)* (referred to in paragraph 3.9*(d)*), was valid, then it would follow that Sky's wholesale prices for Sky Movies were above the competitive level;[96] while if our theory of harm was not valid, then we would not be able to say that Sky's wholesale prices for Sky Movies were above the competitive level and we would not be able to define a wholesale market.

4.131 For this reason, we did not believe that adopting for the purposes of our inquiry a market definition limited to Sky's actual wholesale supply of Sky Movies could lead to an appropriate framework for assessing our theory of harm as this would be close to assuming what we were setting out to test (if the wholesale supply of Sky Movies was defined as a market, it would follow that Sky had a monopoly of that market and, therefore, that there was an absence of competition in that market).[97]

4.132 We noted that reaching this view on an appropriate market definition did not limit the scope of our analysis of competition or cause us to undertake that analysis through a certain 'lens'. As part of our theory of harm, we set out explicitly the need to consider Sky's wholesale supply of FSPTW content and Sky Movies (which has the majority of

[96] Even though we did not see a sustainable source of market power arising simply from wholesaling Sky Movies, it was possible that, as envisaged in our theory of harm, Sky's wholesale price of Sky Movies was above the competitive level due to Sky's retail market power.

[97] As a further indication that Sky's actual wholesale supply of Sky Movies was not an appropriate framework for assessing our theory of harm, we noted that no such market would exist if Sky made no wholesale supply of Sky Movies to any other retailer. A situation where no supply is made (and hence where there is no market) is similar to a situation where there is supply but at a high price (and hence where there is a market 'monopolized' by Sky).

that content) to other pay-TV retailers and, for this reason, throughout this report we refer to Sky's wholesale supply (in particular in Section 8).[98]

Views of parties on the wholesale market definition

4.133 We received a number of submissions on our proposed wholesale market definition, which we considered carefully.[99] In this section, we set out briefly the key points raised by parties and summarize our views on them.

4.134 BT disagreed with our view that there was not a wholesale market for Sky Movies. BT noted that we did not see a sustainable source of market power arising simply from wholesaling Sky Movies and therefore that we did not consider that defining a wholesale market for Sky Movies was a useful step in providing a framework for analysing competition. However, BT said that this reasoning appeared to be circular as we had effectively arrived at a conclusion with respect to issues of market power within the wholesale market in reaching our decision not to define it as a market. BT recognized that market definition was a tool to assist in analysing the effects of market features and was not an end in itself but said that, nonetheless, it was an important step to ensure that such apparent circularity was avoided. In our view, determining the appropriate market definition inevitably overlaps with analysing competition (see paragraph 4.1), but we did not believe that our reasoning was circular. If there is no sustainable source of market power within a candidate market, the frame of reference for assessing competition needs to be wider. This is reflected in the hypothetical monopolist test for market definition, which involves assessing whether a hypothetical monopolist would be able to increase prices above the competitive level by a SSNIP. As we found no sustainable source of market power for a hypothetical monopolist wholesaler of Sky Movies, we did not believe that a wholesale market for Sky Movies was a relevant market for our analysis. BT also highlighted that the wholesale market was relevant to our investigation since it was Sky's restricted distribution of its FSPTW movie content at the wholesale level which reinforced the barriers to acquiring FSPTW movie rights. However, we believed that our framework was appropriate for assessing Sky's wholesale distribution of its FSPTW movie products).

4.135 BT said that we had recognized throughout our market definition analysis that there were no close substitutes for Sky Movies[100], and, in reaching this conclusion, we had effectively determined that there was a narrow wholesale market for services comprising FSPTW movies since wholesale demand was derived from retail/consumer demand. BT added that this conclusion was further reinforced by our finding of a narrow, price discrimination market for FSPTW movie rights upstream. We did not agree. Whilst we recognized that wholesale demand for Sky Movies was derived from the retail demand for Sky Movies (see paragraph 4.122), and consequently the extent of retail substitutes for Sky Movies was relevant to the supply and acquisition of Sky Movies on a wholesale basis, we believed that it was the total strength of all substitutes which was relevant to market definition rather than the constraint imposed by an individual product (see paragraph 4.50). Therefore, in our view, our conclusion that there were no close demand-side substitutes for Sky Movies had no simple

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[98] After reaching our overall findings (see Section 10), we noted that an implication was that there was not an actual wholesale market for Sky Movies.

[99] These comments were on our market definition working paper, on the market definition analysis in our August 2011 provisional findings and/ or our revised provisional findings. Our assessment of market definition was similar in all these documents.

[100] BT noted that we had stated that, if FSPTW movie content was significant to the appeal of the Sky Movies channels, then the Sky Movies channels could not just be substituted by non-FSPTW movie channels. BT also noted that we had provisionally found that: *(a)* FSPTW movie content was significant to the appeal of the Sky Movies channels; and *(b)* cinema, DVD sale and rental, EST, TVOD/PPV, basic pay-TV channels and FTA TV were not close substitutes for Sky Movies at the retail level.

implications either for retail or wholesale market definition. Moreover, we noted that the extent of retailer buyer power was relevant to wholesale market definition (see paragraph 4.124*(c)*) and represented an additional constraint at the wholesale level compared with the retail level.

4.136 We also did not agree that a narrow, price discrimination market for FSPTW movie rights upstream implied that there was a narrow wholesale market. Our finding of a price discrimination market for FSPTW movie rights (see paragraph 4.169)) was based principally on FSPTW rights being distinct from rights in other windows and did not imply narrow downstream markets. We found that the demand for rights was distinct from the demand for movie products, and the demand for movie products was affected by many factors, including the many attributes of these products such as their content (including non-FSPTW content), price, accessibility, etc.

4.137 Virgin Media told us that we should have defined the relevant wholesale market and assessed Sky's position in that market. Virgin Media said that it was artificial for us to address wholesale market definition by examining whether a hypothetical de-concentration of the market into two or more suppliers would facilitate the profitable imposition of a SSNIP. Virgin Media said that such an analysis was subject to a number of unsupported assumptions.[101] However, in our view, the artificiality in this assessment arises precisely from the concept of a wholesale market where nearly all the wholesale supply is from Sky to itself. Our finding on wholesale market definition was based on the unsustainability of stand-alone wholesale market power given the ability of retailers to acquire relevant rights (and the substitutability of other content for major studio FSPTW content) (see paragraphs 4.124 to 4.127), and we did not believe that these factors were subject to any artificiality.

4.138 Virgin Media also said that we should have assessed market definition at the wholesale level by reference to existing demand- and supply-side constraints. It said that, in principle, demand-side substitution at the wholesale level could occur either directly (by retailers substituting one wholesale supplier for another) or indirectly (by final consumers changing how they view movies) but, in reality, direct substitution was not possible because there was only one supplier of Sky Movies so the focus must be on indirect substitution. Virgin Media said that, for this reason, the boundaries of the wholesale market could be no wider than the retail market. In relation to supply-side substitution, Virgin Media pointed to our August 2011 provisional finding that there were significant barriers to entry into the wholesale supply of movie services with FSPTW content, so wholesale supply-side substitution was unlikely. Overall, having regard to the demand- and supply-side factors, Virgin Media concluded that the boundaries of the relevant wholesale market were no wider than the retail market, which it believed to be pay-TV packages including Sky Movies. We agreed with the logic of Virgin Media's reasoning but disagreed with some of its key elements. In particular, we found that the retail market was wider than pay-TV packages including Sky Movies and incorporated all pay TV, including SVOD services (see paragraph 4.74). Also, we did not find that there were significant barriers to providing a movie service which provided some degree of constraint on Sky Movies as LOVEFiLM and Netflix had already done (see paragraph 4.45). For these reasons, we did not agree with Virgin Media's conclusion on the appropriate wholesale market definition.[102]

[101] Virgin Media said that we had recognized that some of these assumptions were unsuported, for example the extent to which content is complementary or substitutable between the wholesalers, the extent of economies of scale and scope, and buyer power.
[102] We also noted that wholesale packages including Sky Movies were different from retail packages including Sky Movies (for example, the former did not include basic channels whereas the latter did).

4.139 Virgin Media also suggested that our August 2011 provisional finding that Sky's wholesale prices were above competitive prices pointed strongly to Sky having wholesale market power. Virgin Media suggested that we should put this analysis in its proper context by providing a suitable frame of reference at the wholesale level. We accepted that, if we were to conclude that our theory of harm was valid, it could imply that Sky's wholesale prices were above competitive prices, but, in our view, the purpose of our market definition was to provide a framework in which to test the theory of harm (see paragraph 4.131) and if it enabled us to do that, then it was an appropriate framework for our purposes.

Finding on wholesale market

4.140 In our view, there was no valid basis for defining a wholesale market consisting of either just the actual wholesale supply by Sky of Sky Movies (see paragraph 4.131) or the total (actual and notional) wholesale supply of Sky Movies (see paragraph 4.129).

4.141 We considered whether there was a need for the purposes of our inquiry for us to assess competition within a wider market for the wholesale supply and acquisition of pay-TV content but decided this was not necessary. In our view, the relevant market for our competition analysis was the pay-TV retail market (see paragraph 4.118) and there was no need for us to consider a wider wholesale market.

4.142 We recognized that our terms of reference referred to the wholesale supply and acquisition of packages including Sky Movies channels but we did not believe that our analysis of competition relevant to this supply and acquisition was limited by not defining a wholesale market.

Movie rights market definition

4.143 At the upstream level, the movie studios supply movie rights to wholesalers and/or retailers of movie products. In seeking to define the relevant upstream market for our purposes, it appeared to us that there were three main issues:

(a) Was there a separate market for movie rights from the major studios (mentioned in our terms of reference) or should the market definition include movie rights from all studios?

(b) Should the upstream market definition include non-movie TV programmes?

(c) If the answer to *(b)* is no, should the market be limited to FSPTW movie rights or should it cover all movie rights?

We set out the issues in this way because it seemed to us that the product was movie rights and the subdivision into windows represented a form of price discrimination in the licensing of these rights by the studios.

Major studios and non-major studios

4.144 Sky and the six major studios told us that there was no sensible basis for distinguishing the movies of the major studios from the movies of non-major studios. For example, Warner's adviser (Professor George Yarrow) told us:

> There is no evidence to suggest that the fact that a movie was produced by a large, rather than a small, undertaking, or by an undertaking

that has associations with 'Hollywood', rather than with somewhere else, makes it a significantly different product. Movies are highly differentiated products, but the predominant differentiating factors are to do with content and 'entertainment value'—at one end of the spectrum, a movie may be a blockbuster, at the other end of the spectrum it may be a near complete dud—and it is these that chiefly determine the value of the relevant intellectual property rights in the markets with which the CC is concerned. It is a matter of record that Hollywood-based studios have a long and distinguished history of producing movies at all points of the relevant 'entertainment value' spectrum.[103]

4.145 Several parties told us that movies from non-major studios were on occasion as successful as those from the major studios. For example, Disney told us that of the ten most successful films at the UK box office in 2009, two (*Slumdog Millionaire* and *The Twilight Saga: New Moon*) were not produced by a major studio. We also noted that, for movies released in 2011, the second, third and sixth most successful at the box office were from non-major studios (*The King's Speech*, *The Inbetweeners Movie* and *The Twilight Saga: Breaking Dawn—Part 1* respectively).[104]

4.146 Nevertheless, we noted that the major studios controlled the rights to a high proportion of the most successful movies and that Sky had [✂] 'output' deals with all of them, under which it licensed the FSPTW rights to the majority of their movies to show on Sky Movies. In addition, Sky had also acquired rights from some non-major studios to show on Sky Movies (including, in [✂] cases, via output deals).[105]

4.147 [✂] This evidence suggested that movies from non-major studios may be close substitutes for those from the six major studios.

4.148 In our August 2011 provisional findings, we noted that the FSPTW rights of some non-major studios had recently been acquired by OTT pay-TV retailers (ie LOVEFiLM and Netflix)[106] and, subsequently, these retailers acquired further FSPTW content. By the time of this report, LOVEFiLM and Netflix held between them the FSPTW rights of most of the large non-major studios.

4.149 We acknowledged that, if we had been able to carry out the hypothetical monopolist test starting with the movie rights of the six major studios, we might have concluded that these studios could impose a SSNIP over the supply of their rights. This was because the six major studios account for a large share of revenue and viewing.[107] However, we did not regard this as an appropriate application of the hypothetical monopolist test as the test should start with a product definition and there seemed to us to be no reason why movies distributed by the six major studios should be regarded as a different product from movies distributed by non-major studios. Moreover, it is inevitably the case that smaller suppliers (often referred to as a competitive fringe) will exercise a limited constraint on the larger suppliers, but this does not mean that smaller suppliers should be excluded from the market definition. For this reason, we believed that the starting point for the hypothetical monopolist test should

[103] A note on market definition by George Yarrow, submitted by Warner.
[104] Rentrak UK Box Office data (2011).
[105] Sky may also acquire from a non-major studio the rights to an individual movie or to a specified selection of movies. Alternatively, non-major studios may license their movies to one of the major studios, which then include them in their output deals with Sky.
[106] Though Netflix was not identified as the licensee at that time.
[107] Figures supplied by Warner, based on EDI Nielsen data, suggested that for the five-year period from 2005 to 2009 the six major studios' share of box office was between 84 per cent (in 2006) and 74 per cent (in 2009).

be all rights to content generally understood as movies and, therefore, in principle, we included FSPTW rights to all movies in the market.[108]

4.150 In its response to our August 2011 provisional findings, BT said there was [✂]. BT said that its view was supported both by its own prior research and that of Ofcom. BT concluded that, as a purchaser of movie rights, FSPTW movies from the non-major studios should not be considered to be a ‘competitive fringe’ to the FSPTW movies of the major studios but rather as a separate non-substitutable product with different product characteristics.

4.151 Although we recognized some of the substantive facts highlighted by BT (eg [✂]), we did not agree with BT’s conclusions. In our view, while the movies of any one individual non-major studio might not be a substitute for the movies of any one major studio, it was possible that the movies of more than one non-major studio could substitute for the movies of a major studio (depending on the movies). While it might not be possible to build a viable subscription business just with the FSPTW content of several non-major studios (ie without other attractive content, such as a wide range of non-FSPTW movie content), it was also not likely to be possible to build a viable subscription business just with the FSPTW content of a single major studio. Just as we did not believe that this should imply that a single major studio was outside the market, we did not believe that non-major studios should be considered outside the market either.

4.152 We concluded that the upstream market definition for movie rights should include the FSPTW rights of all studios.

Movies and other TV programmes

4.153 Sky told us that it broadcast a range of non-movies programming on its channels, and had broadcast significant content such as *The Pacific* and *Clone Wars* on Sky Movies. Sky said that TV channels were not immutable and both their nature and focus could change over time. It said that the fact that its movie channels mainly broadcast movies today did not mean that they always would. We accepted that this was the case and we noted that other content could be a substitute for FSPTW content within movie products. We noted too that, in the USA, premium content channels such as HBO and Showtime showed a significant amount of original programming as well as movie content.[109] However, we saw no evidence suggesting that Sky would change the type of content shown on Sky Movies, and nor did we see evidence that a SSNIP applied to movie rights would induce such a change. During the course of our inquiry, Sky signed contracts to purchase (among other things) premium TV output from HBO, and one series from Lionsgate (*Mad Men*). However, these programmes were not shown on Sky Movies but on Sky Atlantic, which was available to all Sky pay-TV subscribers. Furthermore, we noted that [✂].

4.154 In its response to our August 2011 provisional findings, Sky said that we had misunderstood its submissions. It said that broadcasters were able to substitute among different types of rights by substituting programming spend between channels. It said that, as an example, if it were unable to retain the FSPTW rights of a major studio, one of the obvious uses of the money saved would be to spend it on additional content for Sky’s other entertainment channels, such as Sky 1, Sky Atlantic or Sky Living. Accordingly, in Sky’s view, other types of content rights were substitutes for

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[108] It was put to us that other studios obtained lower revenue for similar quality movies. However, it appeared to us that this point was best considered as concerning competition within the market, rather than as a reason for defining a separate market for the movies of the six major studios. We discuss this issue in Section 9.

[109] HBO has FSPTW content from three major studios; Showtime does not have FSPTW content, though it did prior to 2009.

movie rights. However, we observed [✂].[110] We also noted that, if Sky were to replace content on Sky Movies with content on other entertainment channels, such as Sky 1, Sky Atlantic and Sky Living, this would reduce the value to subscribers of Sky Movies and would be likely to reduce the number of subscribers to Sky Movies.

4.155 It appeared to us that, currently, the purpose of Sky's movie channels was to show movies, not other content. This view was supported by Figure 4.1, which is [✂].[111]

FIGURE 4.1

[✂]

Source: [✂].

4.156 Through the course of our inquiry, both LOVEFiLM and Netflix emerged as other licensees of FSPTW movies. The OTT services of both these providers include some FSPTW content (from non-major studios) together with movie content from subsequent pay-TV windows (from major and non-major studios), and a substantial amount of both library movie content and previously-broadcast TV programmes.[112] It appeared to us from the marketing material and public statements of LOVEFiLM and Netflix that these services used FSPTW content (alongside their other key features such as their price, range of content and accessibility) to attract consumers to their services, which suggested that the FSPTW content on these services was likely to be particularly appealing to consumers, but we did not believe that this had any clear implications for whether the other content on their services (either the non-FSPTW movies (see next subsection) or TV programming) was a good substitute for it.

4.157 In discussing the wholesale market, we noted that the ability of a monopolist to impose a SSNIP depended not just on whether it had close demand-side substitutes but also on other factors which affected the monopoly price versus the competitive price, including the substitutability of potentially competing suppliers, the extent of economies of scope/scale and buyer power. In that analysis, there was an actual monopolist in the possible market we were considering (the wholesale supply of Sky Movies) and the issue was whether the competitive price would be lower than the existing price. With regard to movie rights, there are a number of competing suppliers. Even so, we still considered whether, despite the absence of close substitutes at the rights level, there were factors which might prevent a hypothetical monopolist of movie rights from imposing a SSNIP. In this context, we noted that substitutability between individual movies could be quite weak if consumers' viewing behaviour was driven mainly by a desire to see particular movies rather than by other factors (eg viewing at a particular time or day of the week or when there is nothing else to do).[113] However, even if the substitutability of individual movies was sometimes weak, it seemed to us that, overall, a hypothetical monopolist movie supplier would still be in a stronger negotiating position than the studios are currently. In our view, this was likely to be the case even if the studio was selling to a powerful purchaser within a particular national window (such as Sky in the UK FSPTW).Therefore, we inferred that a hypothetical monopolist movie supplier would be able profitably to impose a SSNIP.

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[110] [✂]
[111] We noted that Sky's output deals with some of the six major studios [✂]. Based on data for July 2009 to June 2010, movies of the week accounted for [✂] per cent of viewing on all Sky Movies channels.
[112] We noted that Netflix has also commissioned some original programming in the USA.
[113] The other two factors mentioned (economies of scope/scale, buyer power) did not seem relevant to movie rights as there was no particular reason why economies of scope/scale beyond those achieved by the existing studios should be significant, and acquirers of movie rights from the studios could not bypass those studios.

4.158 On the basis of all the evidence we reviewed, we did not believe that the upstream market definition for the FSPTW movie rights of all studios should be widened to include TV programming.

FSPTW and non-FSPTW

4.159 The division by the studios of their movie rights into windows is a form of price discrimination. Therefore, it is not possible to have a studio which is a hypothetical monopolist over just the FSPTW as, if the studio has a monopoly over the FSPTW, it must necessarily have a monopoly over all the other windows as well.[114] Nevertheless, in these circumstances, it is possible to define a 'price discrimination' market covering just part of the market. Our guidelines specifically envisage this possibility.[115]

4.160 The FSPTW is distinguished from other windows by a number of factors, including the following:

(a) The length of time since theatrical or DVD release (ie movies in the FSPTW are not in the theatrical window, TVOD/PPV window,[116] SSPTW, TSPTW or FTA window).

(b) Those viewing movies in the FSPTW do not have to pay according to the number of different titles viewed (this feature is also common to the SSPTW, the TSPTW and the FTA window, and some subscription DVD packages).

(c) Movies are available to view instantly either on broadcast linear channels or by VOD, and do not have to be obtained on DVD either through a shopping trip or in the post (this feature is also common to the TVOD/PPV window, the SSPTW, the TSPTW and the FTA window).

4.161 We noted that:

(a) In the UK, the length of the FSPTW and its timing in relation to other windows was similar for all of the six major studios and many other studios. These features of the FSPTW were also similar across many territories.

(b) The price of movies in the FSPTW was generally distinct from the price of movies in other windows, in particular for the high proportion of FSPTW movies which are subject to output deals.

(c) The evidence suggested that movies in most other windows were not close substitutes for movies in the FSPTW (see Appendix 4.8).

4.162 Due to the distinctive characteristics of FSPTW rights compared with rights for other windows, it appeared to us that the appropriate frame of reference for our analysis was a price discrimination market limited to FSPTW movie rights (but including all studios (see paragraph 4.152)). We noted that this would not preclude us from considering a broader range of movie rights or movie content where necessary for our analysis. For instance, in considering competition between pay-TV products, we needed to consider content in a number of different windows, and possibly non-

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[114] If the hypothetical monopolist studio produced all the movies in the FSPTW, it must also have produced all the movies in the other windows (subject to timing differences).
[115] *CC3*, paragraphs 2.32–2.34, especially 2.34 covering the temporal dimensions of demand. The discussion is in a transport context but is equally applicable to our context, where customers are willing to pay for earlier viewing of movies.
[116] By TVOD/PPV window, here we mean the periods of TVOD/PPV sale before and after the FSPTW.

movie content, since there was no pay-TV product with content limited only to FSPTW movies (see Sections 5 and 6).

4.163 We also noted that, although we defined a price discrimination market for FSPTW movies at the rights level for the reasons set out above, this did not mean there was a separate downstream (wholesale or retail) market for products containing FSPTW movies. We recognized that there was no pay-TV product with content limited only to FSPTW movies and downstream products with less FSPTW content may compete with products with more FSPTW content, depending on their other content (ie non-FSPTW movies and non-movie content) and their other attributes (see paragraph 4.125*(a)*).

4.164 In their responses to our August 2011 provisional findings, several of the major studios criticized our finding of a price discrimination market limited to FSPTW movie rights, as set out below:

(a) Paramount said that the value of content rights in any particular window changed over time and depended critically on the extent to which rights to the same content had been released in earlier or contemporaneous windows. We accepted this point and, during the course of our inquiry, we noted [✂]. In particular, we noted [✂]. However, we did not believe that the form of interaction between windows, including with respect to their relative values identified by Paramount, altered the fact that the FSPTW was a distinct window.

(b) Sony Pictures said that we had simply asserted that it was appropriate to define a price discrimination market for FSPTW rights rather than explaining why it was so. In response, we have sought to set out more fully our reasoning (see in particular paragraph 4.162).

(c) Warner said that the FSPTW was only one element of the entire windows release structure, across which it sought to optimize revenues, though this did not mean that there was no substitution on the demand side across windows or products.[117] We accepted that there was substitution on the demand side between rights in different windows and that there could be substitution between products which included movie content from different windows (see paragraph 4.163). However, we observed that the FSPTW was temporally distinct from other windows (except the DVD and EST windows), which implied that substitution between windows was sufficiently weak for them to remain separate. Hence, we found that the FSPTW could be considered a separate price discrimination market from other windows.[118]

4.165 In its response to our revised provisional findings, BT challenged our suggestion that defining a price-discrimination market limited to FSPTW movie rights did not preclude us from considering a broader range of movie rights where this was necessary for our analysis of competitive effects (see paragraph 4.162). BT said that this highlighted our inconsistent application of best practice in market definition. According to BT, our guidelines recognized that the purpose of establishing the boundary of the relevant market was in order to identify the relevant competitive constraints in the market under investigation. In BT's view, if the relevant product market was limited to

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[117] Warner also said that it disagreed with our analysis of market segmentation via the creation of rights windows, which formed the basis of the provisional conclusion that there existed distinct and separate 'price discrimination' markets in the sale of movie rights. We discuss these comments in Appendix 4.8.
[118] This does not apply to the DVD or EST windows as they are contemporaneous with the FSPTW, but our analysis in Appendices 4.1 and 4.8 suggested that DVD and EST products were not close substitutes for products based on content in the FSPTW, and consequently we were satisfied that it remained reasonable to define a price discrimination market limited to FSPTW movie rights.

FSPTW movie rights, then rights in other windows (such as the SSPTW or library window) were not a sufficient competitive constraint on FSPTW movie rights to be included within the relevant market; however, if the competitive effect from these other rights were likely to be sufficiently material, then they should be treated as substitutes and included within the (wider) relevant market. We disagreed. In our view, markets are not unique and the narrowest possible market is not necessarily the relevant market for assessing competitive effects). Furthermore, our market guidelines refer to market definition as a 'useful tool' rather than setting down strict rules and, with regard to price discrimination markets, they specifically say that 'depending on the circumstances of the case, the Commission may decide to define two or more markets, or it may decide to define only one market and note the scope for price discrimination within the market'.[119]

4.166 In its response to our revised provisional findings, Warner said that recent developments, in particular the emergence of the OTT services of LOVEFiLM and Netflix, which combined FSPTW movies with movies in other windows and with a wide range of non-movie content, were likely to increase substitutability across windows. Warner said that these developments supported its view that it was increasingly possible to build a competitive and attractive offering on a mixed content basis. While we agreed that the emergence of services which combined movie content from different windows could increase the substitutability of that content to some extent, we did not see that this changed our finding of a price discrimination market at the rights level limited to FSPTW rights. In our view this market definition provided an appropriate basis for considering issues in relation to the supply and acquisition of FSPTW movie rights.

Geographic market

4.167 In its response to our August 2011 provisional findings, Sky said that many licensors and licensees of rights operated on an international basis. Sky noted that our investigation involved rights to movies produced by US-based movie studios, which were part of corporations operating on a global scale. Sky also noted that Netflix, a US-based OTT supplier, had licensed rights to exploit programming in the UK. Sky said that this demonstrated the international nature of the rights market. In our view, these facts did not point to a global geographic market. In particular, we noted that, while movie studios operated on a global scale, they licensed their movie rights on a national basis. As an illustration of this point, we noted that, for Netflix to expand beyond the USA to the UK, it had been necessary for it to obtain additional movie rights (it could not just use the rights it had licensed for its US operation).

4.168 Sky also said that rights to a wide range of programming (including movies) typically permitted licensees to exploit content in the UK and Republic of Ireland. However, while this may occur when licensees operate in both the UK and Republic of Ireland (as is the case for Sky), we did not believe that studios would require this geographic boundary were another party operating in only the UK or Republic of Ireland to license their rights. Rather, the studios told us consistently that they would divide their rights to maximize overall revenues and if by licensing their rights for the UK and Republic of Ireland separately they could increase their revenues, we would expect them to do so. In any event, we did not believe that a slightly wider geographic market definition for FSPTW movie rights incorporating the Republic of Ireland as well as the UK would alter our analysis of competitive effects. Therefore, we continued to define the geographic market as national.

[119] *CC3*, paragraph 2.34.

Findings on movie rights market

4.169 Overall, we concluded that the appropriate frame of reference for considering issues in relation to the supply and acquisition of FSPTW movie rights was a price discrimination market limited to FSPTW movie rights, but including the FSPTW movie rights of all studios. However, we noted that this did not preclude us from considering a broader range of movie rights where this was necessary for our analysis of competitive effects.

Findings on market definition

4.170 Market definition is not an end in itself but rather is a framework within which to analyse the effects of market features. We considered market definition at three levels, namely in relation to the supply of pay-TV products to consumers, the wholesale supply of premium movie channels and the acquisition of movie rights from studios.

4.171 At the retail level, we started by considering whether the market ought to be limited to Sky Movies, recognizing that it was important to take account of the aggregate constraint on Sky Movies from all substitutes collectively. We found that the frame of reference for our analysis needed to be wider than this because consumers' subscription decisions were affected by other elements of pay-TV packages, including at least basic pay-TV content and sports pay-TV content, and competition for subscribers was across all these elements. We included SVOD-only services provided by traditional pay-TV retailers in the pay-TV retail market for similar reasons.

4.172 We also found that, on the basis that Sky Movies on Now TV offers substantially the same content as Sky Movies on traditional pay TV, and its price is similar to the incremental price of Sky Movies on traditional pay TV (when not bought with Sky Sports), it was highly relevant to our assessment of competition, and we included it in the retail market.

4.173 We found that the SVOD OTT services of LOVEFiLM and Netflix were closer competitors to each other than to packages of traditional pay-TV, and that they were not close substitutes for Sky Movies. Nevertheless, we concluded that they would be regarded as substitutable by some consumers and we judged them to be closer substitutes than other pay-TV movie services previously available, such as BT's Vision Film and PictureBox. Overall, we found there to be sufficient rivalry between these OTT pay-TV services and traditional pay-TV services to include them in the retail market.

4.174 It appeared to us that pay-TV retailers imposed a sufficiently strong constraint on each other for pay-TV retailing to be a separate market and we focused our assessment of retail competition on this market. However, we noted that there were links between competition to supply pay-TV products and competition to supply communications products (broadband and telephony) and also that FTA TV exercised some constraint on pay TV. Therefore, we took into account these 'out of market' constraints as appropriate in our assessment of pay-TV retail competition.

4.175 At the wholesale level, Sky is an actual wholesaler of Sky Movies to Virgin Media and a few small cable pay-TV retailers (and potentially to other retailers) and a notional wholesaler of Sky Movies to itself as a pay-TV retailer. We considered whether it was appropriate to define a market including both the actual and notional wholesale supply of Sky Movies. However, we found that a hypothetical stand-alone wholesaler of Sky Movies would be constrained to some extent by services with content other than major studio FSPTW content and by the possibility of other service providers acquiring FSPTW content from the major studios. Ultimately, we did not see a sustainable source of market power arising simply from wholesaling Sky Movies as such a hypothetical wholesaler would have no direct contact with the customers responsible for the demand for its product. Rather we found that the source of Sky's market power derived largely from its position in the pay-TV retail market. As regards Sky's actual wholesaling of Sky Movies, which was small relative to Sky's notional wholesale supply but in respect of which Sky was an actual monopolist, we found that an assessment of whether this represented a distinct market depended on the validity of the theory of harm we were trying to test. Therefore, we found no appropriate basis for defining a wholesale market consisting of either just the actual wholesale supply by Sky of Sky Movies or the total (actual and notional) wholesale supply of Sky Movies. However, this approach did not limit the scope of our analysis of competition relevant to the wholesale supply and acquisition of packages including Sky Movies channels as set out in our terms of reference.

4.176 At the rights level, we found that the appropriate frame of reference for considering issues in relation to the supply and acquisition of FSPTW movie rights was a price-discrimination market limited to FSPTW movie rights, but including the FSPTW movie rights of all studios. However, this did not preclude us from considering a broader range of movie rights where this was necessary for our analysis of competitive effects.

5. Pay-TV retail competition

Introduction

5.1 In this section, we set out our analysis of competition between pay-TV retailers and our assessment of its effectiveness. In particular, we discuss whether Sky has market power as a retailer of pay TV. This was the first area of analysis in our theory of harm (see paragraph 3.9*(a)*).

5.2 The market with which we were concerned was defined in Section 4 as including pay-TV products relevant to consumer pay-TV subscription decisions,[1] including both traditional pay-TV products and OTT services, and both linear services and SVOD services. In our assessment of market definition we did not reach a view on whether TVOD/PPV and à-la-carte channels were within the market (see paragraph 4.73).[2] However, we took account of these products and also other constraints from outside the market (eg from communications products and FTA TV) where appropriate.

Overview

5.3 We begin this section by providing an overview of the principal competitors in the pay-TV retail market, covering both traditional pay-TV retailers and OTT pay-TV retailers. We then discuss: *(a)* data in relation to parties' market shares and subscriber numbers, noting Sky's persistently high market share over an extended period; *(b)* product differentiation within the pay-TV retail market; and *(c)* evidence on the acquisition of subscribers by pay-TV retailers, in particular evidence on subscribers' switching behaviour, finding that this was consistent with there being barriers to switching traditional pay-TV retailer in the form of subscriber inertia or perceived switching costs and that barriers to switching OTT pay-TV retailer were likely to be lower.

5.4 We then assess the ways in which pay-TV retailers compete for subscribers. We observed that retailers compete with each other to acquire subscribers across a range of features of their services, including price, the quality and range of content offered, standards of service and other facilities, and we noted that marketing to attract new subscribers was an important aspect of competition.

5.5 We then discuss the potential for large-scale entry and expansion in the pay-TV retail market, before going on to consider the degree of innovation that has occurred in the pay-TV retail market, price levels and trends, and Sky's profitability.

5.6 Next, we set out our assessment of the effectiveness of competition in the pay-TV retail market. We found, in particular, that: *(a)* whilst precise market shares among pay-TV retailers depended on the method of calculation, our estimates suggested that Sky's market share had been consistently well above the level often regarded as sufficient to give a company market power (in fact it had been consistently over 60 per cent for several years), and the overall market structure for retail pay TV in the UK had stayed broadly the same since pay TV started to be offered on a significant scale in the early 1990s; *(b)* the evidence was consistent with there being barriers to

[1] In other words, whether to subscribe in the first place and whether to continue subscribing.

[2] We stated in Section 4 that, as well as Sky Movies, we included basic pay-TV and Sky Sports products in the economic market as, in our view, they were relevant to competition for subscriptions. We included in the market both linear channels and SVOD products whether provided as part of a traditional pay-TV package or OTT. We saw little evidence on whether TVOD/PPV (offered either by traditional or OTT pay-TV retailers) or à-la-carte channels were relevant to competition for subscriptions and hence should be included in the market. It did not appear to us that the number and scale of distribution of à-la-carte channels were sufficient to impact to any appreciable extent on competition and we do not refer to such products further in this section.

subscribers switching their traditional pay-TV retailer, though the barriers to switching were likely to be lower in the context of switching between OTT pay-TV retailers; and *(c)* there were significant barriers to large-scale entry and expansion into traditional pay-TV retailing, including substantial sunk costs both in setting up a new platform and in marketing to acquire subscribers (although OTT pay-TV retailers were likely to have [✂] lower SACs), costs of acquiring attractive content, and the threat of a competitive response from existing players. While there had been a significant level of innovation in the UK in pay TV, we observed that this had historically focused on innovations which had favoured satellite technology.

5.7 We then discuss in more detail the implications of the launch of the OTT services of LOVEFiLM, Netflix and Sky (Now TV) on the competitiveness of the pay-TV retail market. In our assessment we took account of the fact that, at the time of our report, there had been only a short period since the launch of the OTT services of LOVEFiLM, Netflix and Sky (Now TV), and as such there was necessarily little measurable evidence of their impact. Nevertheless, we exercised our judgement and considered their likely implications in the light of the information available. We found that, although these services had had a limited impact on demand for traditional pay-TV services to date, we expected this constraint to increase over time.

5.8 Finally, we set out our assessment and conclusions on the effectiveness of competition in the pay-TV retail market.

Overview of the principal competitors

5.9 The structure of the pay-TV supply chain is depicted in Figure 2.1 in Section 2. Content rights holders (including movie studios) supply content to aggregators, including channel providers such as the BBC, ITV, Sky and ESPN, which commission or acquire content and aggregate this content into FTA and pay channels and VOD services. Consumers access pay channels and VOD services from pay-TV retailers.

5.10 The traditional pay-TV retailers are Sky, Virgin Media, BT, TUTV and TalkTalk.[3] For these companies, there is a high degree of integration between traditional pay-TV retailing and platform provision as they operate their own pay-TV platforms and provide their customers with the dedicated devices (eg STB) and network connections (eg to a satellite or cable network) needed to view their encrypted pay-TV channels.

5.11 A pay-TV platform generally provides consumers with access to both FTA and paid-for content and offers consumers a range of packages of pay-TV channels and/or other services such as SVOD (and also TVOD/PPV). Traditional pay-TV retailers may also bundle these pay-TV packages with non-TV services, in particular telecommunications and broadband packages.[4]

5.12 As a result of developments in technology, consumers are increasingly able to view TV content delivered over the Internet, including on their TV screens.[5] A number of market participants considered that such developments had the ability to be positively transformative. In particular, in its Pay TV Statement Ofcom stated: ‘We are now moving into a new period of potentially disruptive technological change, as new means of distributing video content offer consumers greater control over what they

[3] See paragraphs 2.17–2.42.
[4] Except for TUTV, which does not provide telecommunications services.
[5] For example, via Internet-connected games consoles, STBs and Internet-connected TVs.

watch and when they watch it'.[6] However, Ofcom also noted that the ability of new retailers to provide such services depended not just on technology, but on access to the content that consumers wanted to watch.[7]

5.13 In our August 2011 provisional findings, we noted that, despite the existence of the technology to watch TV services over the Internet, there were relatively few Internet-distributed services and most of these were either TVOD services or 'add-on' services of the traditional pay-TV retailers.[8] We also noted that at that stage the launch of YouView had been delayed.[9]

5.14 In the period after our August 2011 provisional findings, however, there were material market developments which at the time of our report had already affected the structure of the market. In particular, in December 2011 and January 2012 respectively, LOVEFiLM and Netflix launched their streaming-only OTT SVOD services, offering a wide range of movies and previously-broadcast TV programmes.[10] Sky also developed the ways in which it distributed content to consumers over the Internet, launching Now TV in July 2012 with Sky Movies as the first content made available on this service. There was also a soft launch of YouView (see paragraph 2.11). In addition, many new TVOD services launched or expanded, including KnowHow (Dixons) and YouTube (Google).

5.15 Since, at the time of our report, the launch of these OTT services was recent, there was necessarily relatively little evidence available to us on some of the usual metrics or measures with which we assess competition. As a result, much of the analysis in this section relates to traditional pay-TV products, and much of the evidence relates to the period before the entry of these OTT services. However, as we clearly had to take these recent developments into account, we exercised our judgement as best we could in the light of the information available in order to form a view as to their likely implications.[11] We discuss the impact of OTT competition in particular in paragraphs 5.152 to 5.162 but refer to OTT services throughout our analysis where appropriate.

Number of subscribers and market shares

5.16 Figure 5.1 shows the monthly number of pay-TV subscribers for the three largest retailers (Sky, Virgin Media and BT Vision) up to May 2012.[12] Since 2003, Sky has

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[6] Paragraph 1.18.

[7] In BT's view, over the long term there could be more opportunities for consumers to benefit from, for example, innovative SVOD services. BT told us, however, that such consumer benefits were unlikely to arise if the specific competition issues surrounding access to FSPTW movies content were not addressed.

[8] For example, Sky had made some of its content available to its DTH subscribers on various Internet-connected devices via Sky Go. Sky also offered a stand-alone Sky Go 'monthly ticket' (ie an Internet-only service without a DTH service), [✂] this had [✂] subscribers.

[9] YouView is discussed in paragraphs 2.11, 2.162 & 2.164–2.166.

[10] See Sections 2 & 4, and Appendices 4.1 & 4.2. The LOVEFiLM streaming service is also available packaged with its DVD rental-by-post offering. LOVEFiLM offered a streaming service at the time of our August 2011 provisional findings but it subsequently enhanced significantly the content on this service and, in November 2011 it repackaged its hybrid (streaming and DVD-rental-by-post) offerings. Since December 2011, LOVEFiLM has also offered its streaming service on a stand-alone basis (ie not bundled with DVD rental by post). In the light of these changes, we refer to LOVEFiLM as having entered the market as a pay-TV retailer.

[11] These developments caused us to reconsider our previous assessment of the relevance of viewing of content distributed over the Internet to our inquiry and to reappraise the implications of such methods of distribution of movies for the central issues under consideration.

[12] Customer numbers include subscribers to Virgin Media's M-pack which does not include pay-TV channels (it offers subscribers access to FTA channels, PPV services, catch-up content and to a small amount of free, advertising-funded VOD content). Virgin Media's M-pack [✂] to new customers. Similarly, BT Vision's numbers include subscribers to its Essentials package (introduced in summer 2011) which does not include any of BT Vision's subscription packs but offers a PVR and access to content within BT's other pay-TV subscription packs, but on a TVOD basis. In addition to those who take a subscription, BT Vision also has customers who can just purchase content on a TVOD/PPV basis (it had about [✂] such customers in October 2011).

increased its number of subscribers at an average rate of 4.4 per cent a year, though recently the rate of growth has reduced.[13] The rate of growth for Virgin Media has been lower ([✂] per cent a year since 2003).[14] BT Vision started offering pay-TV in December 2006 and, by May 2012, it had gained approximately [✂] million pay-TV subscribers (compared with 9.5 million for Sky and [✂] million for Virgin Media).[15]

FIGURE 5.1

Total pay-TV subscribers of Sky, Virgin Media and BT Vision

[✂]

Source: Sky, Virgin and Ofcom.
Note: Virgin Media subscriber numbers include subscribers to Virgin Media's M-pack. Prior to January 2007 we use Ofcom data [✂]. The other smaller pay-TV retailers are not included in this figure due to incomplete data.

5.17 Figure 5.2 shows the market shares from February 2003 to May 2012 for each of the traditional pay-TV retailers mentioned in paragraph 5.10, based on total number of subscribers. Sky and Virgin Media have had the largest shares.

5.18 Sky's market share on the basis of its subscriber numbers was [✂] per cent in the 12 months to May 2012,[16] and had been between [✂] and [✂] per cent over the previous eight years. Over the same period the share of Virgin Media ranged between [✂] and [✂] per cent.[17] In 2011 and 2012, Sky's market share was in the range of 60 to 80 per cent, and Virgin Media's market share was in the range of 20 to 35 per cent. The entry of TalkTalk and TUTV in 2004, as well as BT Vision in 2006, caused only a small impact on the market shares of both Sky and Virgin Media. We estimated that the Herfindahl-Hirschman Index (HHI) of concentration for pay TV was around 5,000 up to May 2012.

FIGURE 5.2

Market shares by pay-TV retailer

[✂]

Source: Subscriber data provided by the parties.
Note: [✂].

5.19 Calculating market shares on the basis of subscribers to traditional pay-TV retailers did not take into account purchases of relevant content on an OTT basis or transactional purchases. If we were to add in the OTT SVOD subscriber numbers of LOVEFiLM and Netflix for May 2012 (see Appendix 4.2, Table 2), Sky's market share would reduce to about [✂] per cent and the HHI to about [✂]. However, as we note in Appendix 4.2, the price of OTT SVOD services is much less than that of traditional

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[13] The rate of growth in subscribers for each provider (ie compounded annual growth rate (CAGR)) is computed as: CAGR=$\left(\frac{Subscribers_{2012}}{Subscribers_{2003}}\right)^{1/t}-1$ where t is the number of years. For both Sky and Virgin Media, we use the 12 months starting February 2003 as the base year and we compute the growth to the 12 months ended May 2012.
[14] If subscribers to Virgin Media's M-pack are excluded from the current numbers, Virgin Media's customer numbers would have been [✂] over the period ([✂]).
[15] If subscribers not receiving paid-for content (that is those on Virgin Media's M-pack and BT Vision's Essentials pack) were excluded, BT Vision's subscriber numbers would reduce to [✂] million and Virgin Media's to [✂] million.
[16] Excluding Virgin Media's M-pack customers would reduce Virgin Media's share for the 12 months to October 2011 from [✂] to [✂] per cent and increase Sky's share from [✂] to [✂] per cent.
[17] Alternative measures of calculating market shares did not show a significantly different picture. Indeed, Sky's revenue share tended to be slightly higher than its share of subscribers because its average revenue per subscriber was higher than that of other operators.

pay TV and measuring market shares simply on the basis of subscriber numbers may overstate the impact of OTT SVOD services, compared with an estimate based on pay-TV revenue. We made a rough estimate of pay-TV revenue and our estimates suggested that Sky's share of pay-TV revenue in May 2012 was around [✂] per cent and the HHI [✂]. The difference from subscriber shares reflected that Sky's revenue per subscriber is high relative to [✂] OTT pay-TV retailers.[18] In summary, over recent years the market has been characterized by very high and stable concentration, with two main suppliers and a fringe of smaller suppliers. Sky's market share has been persistently above 60 per cent.

Product differentiation

5.20 Pay-TV products are differentiated on a number of dimensions, including by reference to their geographical coverage, facilities offered, content and contractual terms.

5.21 In terms of the geographical coverage of different platforms,[19] Sky and, following digital switchover, TUTV (which relies entirely on DTT) are available to almost all homes in the UK. OTT services can reach all homes with a broadband Internet connection, which is estimated to be approximately 76 per cent of UK households,[20] and BT Vision is available to BT broadband homes where a broadband line speed of at least 2Mbits/s is available. Virgin Media is available to only about 50 per cent of homes, as explained in paragraph 2.28. We understood that the existing TalkTalk TV service, which had not been marketed actively for a while, could reach only a small proportion of homes near TalkTalk's unbundled exchanges, though TalkTalk told us that it intended to relaunch its pay-TV service in 2012 with a YouView-compatible STB.

5.22 We recognized that the technology used affected both the quality and range of the products offered. For example, compared with cable and IPTV technology, a satellite delivery mechanism can transmit more readily a large range of channels and more channels in HD, but VOD and other interactive services less readily. As a result, Sky consumers can view a larger number of FTA channels than pay-TV subscribers on other platforms,[21] but many Sky subscribers (specifically those without Sky's Anytime+ service) have a more limited range of VOD content than subscribers of Virgin Media and BT Vision.

5.23 Traditional pay-TV retailers offer customers enhanced facilities, such as multi-room, a PVR and VOD, often for an additional charge.[22] Following the launch by some of the traditional pay-TV retailers of their services on an Internet-distributed basis (eg Sky Go and Virgin Player) and the launch of OTT pay-TV services, pay-TV retailers also compete in terms of device accessibility (eg mobile phones, tablets, games consoles, etc).[23] All pay-TV retailers also compete on the basis of the standard of service that they offer.

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[18] We did not reach a view on whether TVOD/PPV sales influenced consumers' pay-TV subscription decisions and hence were within the market (see paragraph 4. 73) but we observed that the value of such sales by traditional pay-TV retailers was low relative to total pay-TV sales. We also found that, at the time of our report, the value of TVOD sales over the Internet was small relative to total pay-TV sales, so their inclusion in the market would have had little impact on market shares. Our assessment did not include SVOD or TVOD/PPV sales of 'adult' content on the basis that we did not see any evidence that sales of this type of content were relevant to competition for subscribers between pay-TV retailers.

[19] See paragraphs 2.15 & 2.16.

[20] See paragraph 2.16.

[21] Sky subscribers can view encrypted FTA channels, while other consumers receiving satellite broadcasts generally cannot. There are about 260 FTA channels available to households with a Sky STB, compared with around 50 FTA channels on Freeview.

[22] Sometimes, such facilities are introduced for a premium charge but, after a period of time, they are included in the standard price. HD services are also frequently an additional bonus or add-on.

[23] This requires agreement with the relevant platforms or device manufacturers, for example Apple and Google Android in tablets and mobile phones, and Sony Computer Entertainment, Microsoft and Nintendo in games consoles.

5.24 In terms of content, consumer research carried out by Ofcom found that programming (ie channels) was the main feature which consumers cared about when making decisions about their pay-TV service. In an Ofcom 2009 Omnibus Survey, 64 per cent of pay-TV subscribers and 71 per cent of Sky subscribers said that content was one of the three most important features, compared with 6 and 4 per cent who found VOD and HD as important respectively.

5.25 Traditional pay-TV retailers have focused on offering a wide range of content (including premium movies and sports content) at different price points.[24] Sky and Virgin Media offer broadly similar channel content, although they package the basic channels available differently. BT Vision, TUTV and TalkTalk offer a narrower range of linear channels, though BT Vision offers its subscribers additional content on a VOD basis and is in the process of increasing its ability to provide linear channels (by adding an IPTV transmission capability).

5.26 As discussed in Appendix 4.2, the OTT services of LOVEFiLM and Netflix are differentiated from traditional pay-TV services in a number of respects relating to content,[25] including: *(a)* they do not offer linear channels; and *(b)* they offer a single package with a mixture of movie and TV content, rather than subscribers choosing from a number of packages with different amounts of content at different price points.[26] The movie content offered by LOVEFiLM and Netflix includes some movies in the FSPTW (from non-major studios) but these services offer far less FSPTW content than is available on Sky Movies. LOVEFiLM and Netflix also offer SSPTW content and a large number of library movies from both major and non-major studios, as well as previously-broadcast TV programmes (see Appendix 4.2, Table 1). The OTT services of LOVEFiLM and Netflix are also differentiated from traditional pay-TV services in not requiring any long-term contract (ie they can be cancelled on a month's notice). One reason for this may be that traditional pay-TV retailers typically subsidize the cost of STBs to consumers and need to recoup this investment over time, whereas OTT pay-TV services do not require an STB.

Acquisition of subscribers by pay-TV retailers

5.27 Competition between pay-TV retailers (both traditional and OTT) is to acquire and retain subscribers (see Section 4). In assessing how competition takes place for subscribers, we took account of the different types of packages offered by traditional and OTT pay-TV retailers and their different business models, as discussed above. However, as an initial observation in relation to subscriber acquisition activity, we noted that both types of pay-TV retailer often seek to attract subscribers to their services with introductory offers (eg free or discounted periods).

5.28 In this subsection, we begin by discussing competition for subscribers between traditional pay-TV retailers, as these are the companies for which we had most evidence. However, in considering this evidence, we kept in mind that it related to a period prior to the recent entry of OTT services, which had changed the number and the nature of the choices available to consumers making subscription decisions. We considered the implications of this entry throughout. We began by reviewing the data on subscriber switching behaviour.

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[24] Although the range which they are able to offer can be affected by technological constraints.
[25] These aspects of differentiation are in addition to those in relation to the distribution of their services and the hardware and infrastructure required to receive them, and in relation to pricing.
[26] LOVEFiLM's streaming service is available packaged with DVD rental by post and LOVEFiLM offers different numbers of DVDs by post at different prices. All LOVEFiLM's streaming customers on unlimited packages have unlimited access to the full range of content available on this basis.

Subscriber switching behaviour

5.29 In December 2010 (ie before the entry of LOVEFiLM and Netflix), we carried out our first survey.[27] This survey suggested that about 10 per cent of pay-TV subscribers had first obtained a pay-TV service within the last 12 months, and 6 per cent of pay-TV subscribers had switched their pay-TV retailer in the last 12 months (see Table 5.1). The survey also suggested that switching may have increased over time.[28]

TABLE 5.1 **How long ago respondents first obtained a pay-TV service and switched**

percentage of respondents with pay TV

Period: within last	*When obtained first pay-TV service*	*Switched**
3 months	3	2
6 months	5	4
12 months	10	6
3 years	21	13
10 years	58	20
Total who knew period	98	22
Didn't know period	2	0
Total†	100	22
Never switched		79
Sample	890	890
Weighted sample	684	684

Source: CC survey.

*Includes all who previously had a pay-TV service.
†Total includes those responding 'More than 10 years'.
Note: The first question was 'When did you first get a TV service you pay for?'. The questions in relation to switching were 'Have you ever bought a TV service from any of these providers?' and 'When did you most recently switch to X?'.

5.30 We also analysed data from Sky on its subscriber acquisitions and losses during the three years to September 2010 (see Appendix 5.1). This data appeared [✂] with the results of our survey for all pay-TV users. Sky's data suggested that, when subscribers stop subscribing to [✂] (see Figure 5.3). The data from Sky also suggested that there had been [✂] in switching during the three years to September 2010.

FIGURE 5.3

Methods of TV viewing chosen by Sky subscribers who stop paying their subscriptions (quarterly, 2007 to 2010)

[✂]

Source: Sky.

5.31 Switching rates in pay TV appeared to be low when compared with many other markets for which we had data. Table 5.1 shows that only about 22 per cent of respondents to our survey had ever switched pay-TV service, which compared with rates of about 55 per cent for electricity, 52 per cent for gas, 65 per cent for car insurance, 20 per cent for bank accounts, 32 per cent for fixed line telephones, 40 per cent for

[27] See Appendix 4.10 for the full survey report.
[28] 13 per cent of respondents said that they had switched within the last three years, implying an average annual switching rate of 4.3 per cent over three years, and 20 per cent within the last ten years, implying an average annual switching rate of 2.0 per cent over ten years. These trends could reflect a genuine increase or imperfect recall of events some time ago (or it could reflect other effects, including multiple switching and some previous switchers ceasing to take pay TV and hence not being included as switchers).

mobile phones and 30 per cent for Internet connection (all 2008 to 2010 data).[29] The annual pay-TV switching rate of 6 per cent suggested by our December 2010 survey compared with rates of about 16 to 18 per cent for electricity, 16 to 19 per cent for gas, 29 to 34 per cent for car insurance, 3 to 5 per cent for bank accounts, 7 to 10 per cent for fixed line telephones, 8 to 12 per cent for mobile phones and 7 to 8 per cent for Internet connection (all 2008 to 2010 data).[30]

5.32 We estimated that in 2010 about 6 per cent of pay-TV subscribers ceased to subscribe to pay TV. We then calculated that, if we were to treat all these subscribers as switching to FTA TV (on the basis of our finding that FTA TV exercises some constraint on pay TV (see Section 4)), this would increase the pay-TV switching rate from 6 to 12 per cent, which would be slightly higher than the rates for communications products but still lower than for electricity, gas and car insurance.

5.33 As to why pay-TV subscribers did or did not switch between pay-TV providers,[31] Table 5.2 shows an analysis of the reasons for switching pay-TV provider given by respondents to our December 2010 survey.[32,33] The main reasons given were related to price (including the price of bundled communications products) and quality. However, about 10 per cent of these respondents said that they had switched their pay-TV provider because they had moved house.

5.34 Achieving a cheaper TV package or a cheaper TV/communications bundle were the reasons given most frequently for changing provider (overall 30 per cent and 28 per cent). These were the top two reasons given by consumers who had switched (and now subscribed) to a provider other than Sky, and were two of the three reasons given most frequently by consumers who had switched (and now subscribed) to Sky (22 per cent and 19 per cent respectively).

5.35 Consumers who had switched to Sky were more likely to refer to reasons relating to programme quality. In particular, 27 per cent of those who switched to Sky said that they had switched to get a better range of programmes, 16 per cent because they were unhappy with their previous provider, and 14 per cent to get a better sports package. However, only 7 per cent stated that they had moved to Sky to get a better film package.

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[29] Source: *The Consumer Experience 2010*, Ofcom, December 2010, Figure 138, which uses responses from Ofcom's consumer decision-making surveys. Ofcom provided us with a summary of responses for switching by pay-TV respondents from these surveys and from this we calculated the percentage having ever switched pay-TV supplier to be 18 per cent from Ofcom's 2010 survey, 18 per cent from Ofcom's 2008 survey and 17 per cent from Ofcom's 2010 survey. This was slightly below the 22 per cent rate from our own survey (see Table 5.1) but may be explained by our estimates for Ofcom's respondents taking pay TV bundled with communications products including only switching of the whole bundle and switching of pay TV where it was the most recent element of the bundle switched (which may lead to an underestimation of switching if respondents had switched pay TV prior to their most recent switch of one element in the bundle).

[30] ibid. The range reflects the rate of annual switching for 2008–2010 shown in Figure 139, which used responses from Ofcom's consumer decision-making surveys. Ofcom provided us with a summary of responses for switching by pay-TV respondents from these surveys and from this we calculated the percentage switching pay-TV supplier (or for those having pay TV bundled with communications products, those switching any element of the bundle) in the previous 12 months to be 6 per cent from Ofcom's 2010 survey, 8 per cent from Ofcom's 2008 survey and 10 per cent from Ofcom's 2010 survey. This appeared consistent with the 6 per cent rate calculated from our own survey (see Table 5.1) if we took into account that the percentages we calculated from the Ofcom survey may reflect some switching of communications products by those taking a bundle of services.

[31] With regard to why pay-TV subscribers dropped pay TV, based on a small sample (63), our December 2010 survey suggested that the main reasons were: pay TV was too expensive (40 per cent unprompted, 92 per cent after prompting); moving house (21 per cent, 51 per cent); too busy (13 per cent, 33 per cent); pay TV did not have desired channels (13 per cent, 33 per cent)—see Appendix 4.10, Figure 18. Similarly, when all those without pay TV (152 respondents) were asked why not, the main reasons given were that it was too expensive and that they were too busy—see Appendix 4.10, Figure 25.

[32] Our December 2010 survey referred to the company providing respondents' pay-TV service as their 'pay-TV provider' and therefore, in paragraphs reporting results from this survey, we refer to 'pay-TV provider' rather than pay-TV retailer.

[33] It should be noted that Table 5.2 covers all respondents who had ever switched and, in some cases, this was many years ago.

TABLE 5.2 **Why respondents decided to switch**

	percentage of all who switched			
	Total	*Sky**	*Virgin**	*Other**
Cheaper TV	30	22	39	38
Cheaper broadband/telephone/bundle	28	19	39	31
Better range of TV programmes	19	27	11	14
Unhappy with previous provider	12	16	9	3
Moved house	9	10	6	14
Better sports package	7	14	0	3
Better films package	4	7	2	3
Recording/storing programmes	4	6	3	0
Reliability	4	7	1	3
Special offer/good deal/package	4	5	3	3
Quality of reception/signal	3	2	5	0
HD	2	2	1	3
Did not want satellite dish/cable	2	0	4	0
Faster broadband	1	0	3	0
Persuaded by sales person	1	1	1	0
Better choice	1	1	0	0
Other reasons	14	15	13	10
Total	145	154	140	125
Sample	216	95	92	29
Weighted sample	145	72	59	15

Source: CC survey.

*Percentages are of Sky/Virgin Media/Other subscribers. Figures for 'other' should be interpreted with caution due to low sample sizes.
Notes:
1. The question was 'Why did you decide to switch to X for your TV service?'.
2. Responses were not prompted. Respondents may have given more than one reason; hence figures sum to more than 100.

5.36 The data in Table 5.1 suggested that, at the time of our December 2010 survey, 84 per cent of pay-TV subscribers were with the same pay-TV provider as they were with 12 months previously (with 10 per cent new to pay TV and 6 per cent having switched). In principle, a low rate of switching could simply be the result of most subscribers regularly comparing the offers of all pay-TV providers and continually preferring the same one. However, the results of our December 2010 survey showed that relatively few pay-TV subscribers had compared providers or considered switching within the last two to three years. Table 5.3 shows that only about 30 per cent of respondents had either switched within the last three years or considered switching within the last two to three years. The remaining 70 per cent had not done so. In our view, this reflected the existence of one or more barriers to switching, ie either switching costs or a degree of subscriber inertia.[34]

[34] We were also provided with the results of research on switching carried out by BT in February 2011 (see Appendix 6.1, paragraph 45*(b)*). Our analysis of the results of BT's survey suggested that [✂] per cent of respondents to BT's survey had not considered switching at all in the last two years; while [✂] per cent had considered switching in the last two years and agreed with the statement 'I considered looking around in the past but did not actively do anything'; [✂] per cent had considered switching in the last two years and agreed with the statement 'I looked at the competitive options but decided to stay'; and [✂] per cent of the total sample selected the statement 'I have come close to switching away in the past but in the end did not' (the remaining [✂] per cent had been with their current pay-TV supplier less than 12 months). For the reasons set out in Appendix 6.1, paragraph 45, we attached less weight to results from the BT survey.

TABLE 5.3 **Consideration of switching by respondents to CC December 2010 survey**

	percentage of respondents with pay TV			
	Total	*Sky**	*Virgin**	*Other**
Whether switched within last three years and, if not, whether considered switching and compared providers				
Switched within last three years	11	10	10	31
Did not switch within last three years but considered switching and compared providers	17	17	19	14
Did not switch within last three years, considered switching but did not compare providers	2	1	5	3
Did not consider switching	69	72	65	52
	percentage of respondents with pay TV who had not switched provider within the last three years			
Reasons respondents to CC survey did not consider switching or (if considered switching but did not actually switch) why they did not switch				
Hassle	32	31	34	22
Happy/satisfied with current provider/no problems	23	24	21	15
Cost more to switch	14	9	22	22
Don't want to change broadband/telephone	12	9	17	20
Can't have/don't want cable/satellite dish	7	8	5	9
Others don't offer TV channels I want	6	9	1	2
Don't trust other providers	4	3	4	7
Not interested in changing/haven't thought about it	2	3	1	0
Contract	2	2	1	0
Like features I have (eg HD, recording)	2	2	1	0
Only just moved to current provider	1	1	1	2
Currently receive good choice/variety of channels	1	1	1	2
Good signals/reception	1	1	1	0
Current provider is market leader	1	1	1	0
Habit/used to current provider	1	1	0	2
Haven't got round to it yet	1	1	0	2
Not aware of other options	1	1	0	2
All the same/no point in changing	1	1	0	0
Better broadband with current provider†	1	0	2	0
Poor previous experience with other providers	1	1	0	0
Will decide when current contract expires	0	0	0	2
Alternative options worse	0	0	0	0
Other	1	1	1	2
Don't know	3	3	2	4
Total	114	114	114	115
Sample†	745	457	242	46
Weighted sample†	576	371	181	24

Source: CC.

*Percentages are of Sky/Virgin Media/other subscribers. Figures for 'other' should be interpreted with caution due to low sample sizes.
†Sample and weighted sample for lower panel, ie respondents who had not switched provider within the last three years. The sample for and weighted sample for the upper panel, ie all respondents, is as shown in Table 5.1.
Notes:
1. The questions were 'Have you considered switching your TV service from X to another provider of TV services that you pay for in the last 2–3 years?'; 'Have you compared providers in the last 2–3 years?'; and 'Why have you not switched/considered switching to another provider of TV services?'.
2. Responses were not prompted. Respondents may have given more than one reason for not switching.

5.37 Respondents to our survey were also asked to give the reasons why they had not considered switching (or, if they had considered switching but had not switched, the reasons why not). As shown in Table 5.3, the most frequently-given reason was the hassle associated with switching. The next most frequently-given reason was that respondents were happy/satisfied with their current provider or had experienced no problems.[35] Given that most respondents to this question had not considered switch-

[35] We also considered the results separately for those who considered and did not consider switching. The main areas of difference were in those saying they were happy/satisfied with current provider/no problems (23 per cent overall, 27 per cent for those who did not consider switching and 9 per cent for those who did); those who said it would cost more to switch (14 per cent overall, 10 per cent for those who did not consider switching and 24 per cent for those who did); those who said they did

ing or compared providers, this evidence was suggestive of customer inertia. Other important reasons given were that they did not want to change broadband or telephone connection (which was relevant to subscribers wanting to take advantage of 'triple play' offers (see paragraph 5.48)), and not being able to have or not wanting to have a cable connection or a satellite dish. Overall, it appeared to us that these responses were suggestive of switching barriers.[36,37]

5.38 Further relevant data from our December 2010 survey is shown in Table 5.4, covering responses on ease of switching and the price reductions required to induce switching. On ease of switching, 7 per cent of respondents said that it was very difficult to switch and 23 per cent said that it was quite difficult, but 17 per cent said that it was neither easy nor difficult, 34 per cent said that it was quite easy and 10 per cent said that it was very easy. Thus, although 69 per cent of respondents had not considered switching (see Table 5.3), more respondents regarded it as easy rather than difficult to switch. This seemed surprising given that the data in Table 5.3 suggested that most respondents had not considered switching (if switching were easy, we might have expected more respondents to have considered it). However, we noted that, in answering this question, respondents might have had in mind matters such as contractual restrictions rather than hassle.[38]

not want to change broadband (12 per cent overall, 14 per cent for those who did not consider switching and 6 per cent for those who did); those who said they couldn't have/didn't want cable/satellite dish (7 per cent overall, 6 per cent for those who did not consider switching and 10 per cent for those who did); and those who said that others did not offer the TV channels they wanted (6 per cent overall, 5 per cent for those who did not consider switching and 10 per cent for those who did).

[36] We also reviewed some Ofcom research from 2007 which was based on a telephone survey (see Annex 14 to Ofcom's First Pay TV Consultation). Compared with our own survey, the results of Ofcom's 2007 research showed a much higher proportion of respondents saying that they did not switch or consider switching because they were satisfied with their current supplier, and a lower proportion saying that hassle was the reason. However, Ofcom's research also showed that a substantial proportion (almost 50 per cent) of pay-TV customers agreed, either strongly or slightly, with statements that: it was difficult to make comparisons between suppliers; they did not know enough to make the right choice between suppliers; and there was a big risk that something would go wrong in the switching process—see Table 5.2. Ofcom stated that its 2007 research suggested that around 70–80 per cent of pay-TV consumers were not interested in finding a new supplier.

[37] In addition, our analysis of responses to prompted questions in BT's survey (to which we attach less weight than our own—see Appendix 6.1, paragraph 45) suggested that [✂] per cent of respondents who had not switched agreed with the statement that they stayed with their current TV service provider because it had all the TV channels/content they wanted; [✂] per cent because they were happy and/or had good experiences with their current TV service provider; [✂] per cent because switching provider would be a hassle; and [✂] per cent because it meant they got all products (TV/phone/broadband) from one supplier (with lower percentages agreeing with other statements).

[38] It may also be that some respondents were thinking about switching from pay TV to FTA TV rather than switching between pay-TV providers (the question referred to 'switching TV provider' rather than 'switching pay-TV provider').

TABLE 5.4 **Further switching data from CC December 2010 survey**

*percentage of respondents with pay TV**

	Total	*Sky†*	*Virgin†*	*Other†*
How easy or difficult respondents thought it would be to switch				
Very easy	10	11	10	13
Quite easy	34	35	33	41
Neither easy or difficult	17	16	19	22
Quite difficult	23	24	24	14
Very difficult	7	6	9	4
Don't know	8	9	7	6
Total	100	100	100	100
Sample	890	536	285	69
Weighted sample	684	435	213	36
How much cheaper it would have to be to make respondents switch (per cent of amount paid for TV/ telecommunications bundle)				
1–5%	2	2	2	2
6–10%	2	2	2	0
11–15%	4	4	6	2
16–20%	7	8	8	0
21–25%	9	10	9	0
26–30%	7	7	9	7
31–35%	6	7	6	5
36–40%	4	4	4	5
41–45%	2	2	2	0
46–50%	8	9	6	4
More than 50%	6	7	6	5
Would not switch	21	21	18	50
Don't know	20	19	22	20
Total	100	100	100	110
Sample	805	494	265	56
Weighted sample	621	400	192	29

Source: CC.

*Percentages for 'how much cheaper' question are of respondents with pay TV who stated the amount paid for TV (and telecommunications services if obtained from same provider).
†Percentages are of Sky/Virgin Media/other subscribers. Figures for 'other' should be interpreted with caution due to low sample sizes.
Note: The questions were 'Thinking about what is involved in switching TV provider, how easy or difficult do you think it would be to switch?'; and 'If someone else offered you exactly the same TV/broadband/landline/mobile, how much cheaper would it have to be per month to make you switch?'.

5.39 Although more respondents to our December 2010 survey regarded it as easy rather than difficult to switch, they also tended to say that they would require very large price reductions to make them switch. 35 per cent of respondents said either that they would not switch or that they would require a price reduction equivalent to over 40 per cent of their current monthly payment; while 63 per cent said either that they would not switch or that they would require a price reduction equivalent to over 20 per cent of their current monthly payment.[39] The responses to this question were also somewhat difficult to interpret: the percentage price reductions given by respondents seemed very large and we noted that some respondents might have had in mind the sort of temporary price reductions associated with special offers (eg a six-month reduction on standard prices).[40] However, the required price reductions were significant even if interpreted as temporary (eg lasting six months), and suggested significant barriers to switching.

[39] These figures assumed that 'Don't knows' (20 per cent of respondents) all required a price reduction of less than the figure quoted. An alternative treatment of 'Don't knows' (eg allocating pro rata with respondents who did know) would lead to higher figures for those requiring price reductions of over 40 and 20 per cent respectively.
[40] There were also a relatively large number of 'Don't know' responses (20 per cent). This was in part due to uncertainty with some interviewers' treatment of responses: where there was uncertainty about interviewers' treatment, GfK recorded responses as 'Don't know'.

5.40 Sky told us that, for most instances of switching, the costs of doing so were negligible. Sky said that switching from Sky to Virgin Media was straightforward. Sky told us that this point was clearly demonstrated, among other things, by Virgin Media's own consumer marketing which included statements such as 'switching's easy … just pick up the phone and we'll take care of everything'. We accepted that it was in the interests of a pay-TV provider to make switching to its service as easy as possible (eg by installing the necessary infrastructure as quickly as possible). We also accepted that a fairly small proportion of traditional pay-TV subscribers were unable to switch because of contractual restrictions, which (for subscriptions to traditional pay-TV) are typically 12 to 18 months, and occasionally 24 months.[41] However, it seemed to us that the low level of switching outside the contracted period was indicative of barriers to switching unrelated to contractual restrictions (as if contractual restrictions alone inhibited switching, we would expect consumers to tend to switch once their initial contracts had expired).

5.41 We also noted that, when customers of traditional pay-TV retailers such as Sky and Virgin Media wished to cancel their subscriptions, they were usually referred to customer retention teams,[42] following which some of these customers decided to continue their subscriptions (see Appendix 5.1).

5.42 We observed that an implication of there being barriers to switching was that traditional pay-TV providers had an incentive to spend significant sums on acquiring new subscribers as, once recruited, new subscribers could be expected to be retained for some time. New subscribers may be those who are new to pay TV or those who are switching between pay-TV providers. Table 5.5 shows that the main traditional pay-TV providers incur costs of about £[✂] to acquire each new subscriber. We noted the increasing trend of Sky's SAC since 2003/04 but also that [✂].[43]

TABLE 5.5 **SACs by traditional pay-TV provider**

£

	*Year**								
	2003/04	*2004/05*	*2005/06*	*2006/07*	*2007/08*	*2008/09*	*2009/10*	*2010/11*	*2011/12*
Sky*	200	237	261	251	253	308	339	376	
Virgin Media†							[✂]		[✂]
BT Vision‡								[✂]	[✂]
TalkTalk§							[✂]		
TUTV¶			[✂]	[✂]	[✂]	[✂]	[✂]		

Source: Data provided by the parties.

*Sky's SAC figures are based on the year ended June, for example the 2009/10 figure is for July 2009–June 2010 .
†[✂], Virgin Media's [✂].
‡ BT Vision's figures are for the year ended March, for example the 2009/10 figure is for April 2009–March 2010. BT told us that its projected SAC for 2012/13 was £[✂].
§TalkTalk's SAC is an average cost based on the period of January–August 2010.
¶TUTV's figures are for the year ended December, for example the 2009/10 figure is for January–December 2009.
Notes:
1. Costs are net of customer revenue and include all costs associated with the marketing, order processing and installation of the TV hardware.
2. Only Sky and TUTV provided more than one year's worth of data prior to 2009/10.

5.43 Taken in the round, we believed that the data on subscriber behaviour was consistent with there being barriers to subscribers switching their traditional pay-TV retailer. In our view, these barriers took the form of subscriber inertia/subscriber perceptions (because most subscribers do not consider switching and many associate switching

[41] Sky's initial contracts are of 12 months' duration but some other retailers have longer contracts.
[42] We noted that it was possible to cancel a Sky subscription by email or letter, ie without going through a call centre.
[43] [✂]

with hassle and/or would require a significant reduction in price to make them switch). Although traditional pay-TV retailers invested substantial sums in acquiring new subscribers, the annual rate of switching among traditional pay-TV retail subscribers remained low at about 6 per cent, with 70 per cent of traditional pay-TV subscribers not even having considered switching their provider within the last two to three years.

5.44 Overall, it appeared to us that, to date, the pay-TV market had been characterized by considerable switching barriers and customer inertia. Each year the vast majority of pay-TV consumers remained with their existing provider, and over a three-year period less than a third of subscribers switched or considered switching. For the small minority of consumers who did switch (about 6 per cent per year based on our December 2010 survey), the most important factors were the price of the pay-TV or overall TV/communications package. The overall range of programming was also important, in particular for consumers switching to Sky. A relatively small proportion (only about 7 per cent) of respondents who had switched to Sky said that they had switched specifically in order to get a better film package. Sports programming appeared to be more influential, with twice as many respondents saying that they had switched to Sky specifically in order to get a better sports package compared with those who switched specifically to get a better film package.

5.45 Given that the OTT services of LOVEFiLM and Netflix only launched in December 2011 and January 2012 respectively, and both launched using free trial offers to attract subscribers, there was limited evidence available to us about these services in relation to switching. However, we noted that barriers were likely to be less of a factor in switching to an OTT service (either through ceasing to subscribe to traditional pay TV or through downgrading a traditional pay-TV subscription) because OTT services *(a)* do not require a long-term contractual commitment; *(b)* do not require the installation of infrastructure (eg a dish or cable) or the delivery of hardware (eg a dedicated STB), meaning that access is quicker and there is no intrusive installation work; and *(c)* are not bundled with communications products, meaning that they are not affected by any hassle associated in switching broadband or telephony services. We noted that inertia was also likely to be less of a factor in switching away from OTT services as subscriptions could be cancelled online more readily than appeared to be the case in relation to traditional pay-TV services.

5.46 Overall, it seemed to us that barriers to switching between OTT suppliers were likely to be lower than between suppliers of traditional pay TV.

Methods by which pay-TV retailers compete for subscribers

5.47 Pay-TV retailers compete with each other to acquire subscribers across a range of features of their services, including price, the quality and range of content offered, standards of service and other facilities.

5.48 The list prices of traditional pay-TV services usually consist of an initial set-up/activation/equipment charge and a menu of monthly charges. Traditional pay-TV retailers usually offer discounts to new subscribers which at least offset the initial set-up/activation/equipment charge, but may be greater. Most traditional pay-TV retailers offer communications as well as pay-TV products and may offer a ‘triple play’ product (ie TV, broadband and fixed line telephony, including line rental) at below the price of the constituent TV and communications products, either via a lower list price or by offering greater discounts to new subscribers.

5.49 LOVEFiLM and Netflix have a single price for their SVOD-only services and Sky Movies on Now TV is currently available at the single price of £15.[44] LOVEFiLM, Netflix and Sky Movies on Now TV seek to attract new subscribers through offering free trials (and LOVEFiLM has also, on occasion, offered discounts off the monthly charge).

5.50 Traditional pay-TV retailers have focused on offering a wide range of content at different price points,[45] though the quality and range of content which they offer can be affected by constraints on its availability, in particular movies and sports content.

5.51 In its Pay TV Statement, Ofcom found that the availability of Sky Sports affected competition between pay-TV retailers. As a result of its finding, Ofcom made a regulatory decision in March 2010 to require Sky to offer its Sky Sports 1 and Sky Sports 2 channels to other retailers with maximum prices for the SD versions set by Ofcom.[46] This decision is currently under appeal in the CAT. We do not comment on the availability of Sky Sports, except to note that, if Ofcom's decision were to be upheld by the CAT, this would suggest that competition had previously been limited in relation to the availability of sports content.[47]

5.52 With regard to movies, BT told us that, as BT Vision and TUTV were unable to offer an FSPTW movies service, they were both unable to compete effectively for subscribers to their platform. Similarly, Virgin Media told us that it was unable to compete effectively for subscribers because Sky Movies was provided to Virgin Media on uneconomic terms, providing Virgin Media with little or no incentive to promote and market Sky Movies actively. However, Sky told us that Virgin Media's lower sales of Sky Movies did not mean that Virgin Media was an ineffective competitor to Sky for the acquisition of new pay-TV subscribers who wanted to subscribe to packages which included Sky's movie channels, including existing Sky subscribers. Sky said that *(a)* Virgin Media offered similar products to Sky; *(b)* while price comparisons were complicated, there was no reason to believe that Virgin Media was at a competitive disadvantage to Sky by virtue of setting higher prices; *(c)* Virgin Media's product offering was differentiated from that of Sky; and *(d)* the historical problems of the cable companies were now behind Virgin Media and it had been widely acknowledged that Virgin Media had improved its customer service and was a successful growing company. Sky also said that its view that Virgin Media was an effective competitor to Sky was supported by statements by Virgin Media's management and by Virgin Media's marketing material.[48]

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[44] Although LOVEFiLM also offers packages combining SVOD with DVD rental by post.
[45] The range which they are able to offer can be affected by technological constraints (see paragraphs 5.22–5.24).
[46] The requirement was limited to retailers on platforms other than Sky's (Pay TV Statement, Ofcom, 31 March 2010). Ofcom's reference to us of issues relating to movies on pay TV followed in August 2010.
[47] At least until the CAT's interim relief order (29 April 2010), under which Sky Sports 1 and 2 are supplied at regulated prices set by Ofcom pursuant to its decision. In the interim period prior to the CAT's judgment, BT, TUTV and Virgin Media have been paying into escrow the difference between the regulated prices set by Ofcom and Sky's wholesale prices: www.catribunal.org.uk/files/1152IR_BSKYB_Order_29.04.10.pdf.
[48] Sky referred to Virgin Media marketing literature which gave reasons for switching from Sky to Virgin Media, including that it was easy to switch and that prices were lower. Sky quoted from one example from February 2010, where Virgin Media stated :

1. We've got your favourite Sky channels, including Sky1, Sky Sports and Sky Movies.
2. Our V+ HD box lets you record two channels while watching a third (Sky+ HD can't).
3. Only Virgin TV lets you access a huge ever changing library of over 500 movies and thousands of great TV shows and music videos, stored up to watch whenever you like.
4. We let you watch BBC iPlayer, ITV Net Player and 4OD on your TV, not just your PC.
5. And our TV comes down a state-of-the-art fibre optic cable, not an aerial or dish. So when the weather's bad, your picture won't be.
6. That same fibre optic cable can bring you up to 50 Mb broadband too (the fastest in the UK).
7. Only we can deliver your home services down one line, so we can offer you great value. TV broadband and calls start at just £16 a month when you take a Virgin phone line for £11 a month.
8. Servicing and repairs are free too (Sky charges £65 a call out when you're out of warranty).
9. You street's already connected to our fibre-optic network, so it's easy to get switched on.

5.53 An important aspect of competition is that pay-TV retailers engage in marketing activities to attract new subscribers. As shown in Table 5.6, Sky's marketing expenditure is considerably greater than that of BT and Virgin Media. Sky's expenditure on marketing pay TV was at least [✂] times as great as that of BT and Virgin Media in both 2009 and 2010; and Sky's total marketing expenditure was [✂] that of BT and Virgin Media in 2009, and was [✂] per cent greater than that of BT and [✂] per cent greater than that of Virgin Media in 2010.

TABLE 5.6 **Comparison of marketing spend for Sky, BT and Virgin Media**

£ million

	2009			*2010*		
	*Sky**	*BT*	*Virgin Media*	*Sky**	*BT*	*Virgin Media*
TV	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Broadband	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Phone		[✂]	[✂]		[✂]	[✂]
Bundles	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Total	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

Source: CC calculations based on Nielsen Media Research data (supplied by Sky).

*Figure for broadband includes phone (Sky told us that it had not run any stand-alone broadband or telephony campaigns) and the figure for bundles is for triple play bundles.

5.54 Pay-TV retailers may focus their marketing specifically on areas where they believe they have an advantage over their competitors. BT told us that when, following the CAT's interim relief order (see the footnote to paragraph 5.51), it started to offer the Sky Sports 1 and 2 channels, Sky launched a large-scale new marketing campaign focused on the benefits to consumers of getting all Sky Sports content (ie not just Sky Sports 1 and 2). BT said that detailed figures from Nielsen showed that Sky's UK marketing expenditure specifically in relation to Sky Sports increased dramatically in July/August 2010 compared with the same period in 2009. BT said that the Nielsen figures showed that Sky's July marketing spend in relation to Sky Sports increased by [✂] per cent and its August spend by [✂] per cent. BT noted that, within this, Sky's July Sky Sports spend in relation to each of outdoor advertising, press and radio increased by more than [✂] per cent compared with July 2009; while spend in relation to TV advertising increased by [✂] per cent.

5.55 OTT pay-TV retailers similarly engage in marketing activities to attract new subscribers. LOVEFiLM told us that its total planned spend on marketing in 2012 was about £[✂] million and in 2013 was about £[✂] million; and Netflix told us that [✂]. Sky told us that, [✂]. As set out in Appendix 4.2, Sky told us that [✂]. In addition, in relation to Now TV, Sky has stated publicly that it estimated the launch costs for Now TV, relating to the marketing and support of the new service, to be approximately £30 million in the 2012/13 financial year.[49]

Entry and expansion

5.56 In this subsection, we discuss the opportunities for new entry or expansion to make a significant difference to the existing market. We were concerned with large-scale entry or expansion as this had the potential to affect competition significantly rather

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10. We'll install it for free and give you the first 2 months free too, if you call before 28th Feb.
Sky added that this example was from before the launch of Virgin Media's new TiVo STB and its 100MBits/s broadband product, both of which had further improved Virgin Media's product set and its effectiveness as a competitor to Sky.

[49] http://corporate.sky.com/documents/pdf/latest_results/fy_press_release_1112.

than niche entry, and we concentrated on subscription pay-TV services as these services were the focus of our assessment of pay-TV competition.[50]

5.57 We considered the following entry strategies:

(a) starting a new pay-TV platform;

(b) retailing via the platforms of existing pay-TV or FTA retailers;

(c) expansion by existing smaller traditional pay-TV retailers; and

(d) OTT pay-TV retailing.

We discuss each in turn.

Starting a new pay-TV platform

5.58 We considered the possibility of entry as a new traditional pay-TV retailer by starting a new pay-TV platform, ie a service which includes access via a platform-specific STB/PVR to a broad range of paid-for content offered at a variety of different prices. Content could be delivered to a new pay-TV platform using satellite delivery and/or delivery via a closed Internet connection (IPTV), as well as through DTT.[51] We discuss first a new pay-TV platform using satellite or satellite/IPTV delivery before discussing the other forms of platform entry.

5.59 Ofcom's evidence suggested that a potential entrant could launch a completely new satellite service as there was an available supply of satellite capacity.[52] Furthermore, even if the capacity on the existing satellites used for TV in the UK was fully utilized, satellite dishes could be changed to pick up signals from other satellites in other orbital positions. Therefore, there did not appear to be a significant technical constraint on setting up a new platform using satellite delivery.

5.60 In considering entry, it is relevant to distinguish between, on the one hand, sunk and fixed costs, which are either irrecoverable or cannot be readily adjusted for changes in scale, and, on the other hand, per-subscriber costs and any other variable costs, which depend on the scale the entrant eventually achieves. As entrants inevitably face more uncertainty about their future scale than incumbents, and sunk and fixed costs cannot be adjusted to the scale an entrant eventually achieves, an entrant may face costs per subscriber which, other things being equal, are greater than those of incumbents. This disparity in costs can act as a barrier to entry. In the context of entry via a satellite or satellite/IPTV platform, a potential new traditional pay-TV retailer creating a new platform would incur significant costs both in setting up its platform and in acquiring subscribers. In relation to the former, the new entrant would be likely to have to provide, or subsidize the provision of, receiving dishes and STBs as other entrants have done.

5.61 In relation to customer acquisition, we noted that, despite existing traditional pay-TV retailers incurring significant costs to acquire new subscribers, around 70 per cent of subscribers to traditional pay TV had not even considered changing their provider in

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[50] See Section 4.
[51] In principle, content could also be delivered over a dedicated physical network, such as that of Virgin Media. However, the cost of constructing such a network would be extremely large.
[52] Ofcom said that the possible exception was for capacity on Astra 2D. This is the only satellite that has a broadcast footprint focused on the UK, allowing FTA broadcasters to control 'overspill' without the need to use Sky's conditional access services (see Appendix 5.2, paragraph 6).

the two to three years prior to our December 2010 survey.[53] We also noted data showing that [✄].[54] This made it likely that a potential large-scale new traditional pay-TV retailer would need to incur substantial irrecoverable costs in marketing its service to subscribers. Furthermore, it was likely that the entrant would incur much greater marketing costs per subscriber than incumbents, as each of the incumbents had an existing subscriber base. It appeared to us that the need to incur large marketing costs was a significant barrier to large-scale entry as a traditional pay-TV retailer.

5.62 In a highly concentrated market, such as pay TV, a potential large-scale entrant would also need to consider the impact of its own entry on competition. In a number of countries (including the UK), competition between satellite pay-TV platforms appears to have been unsustainable, with the result that one or both platforms encountered financial difficulty and the two platforms merged.[55] The entrant may also expect incumbents to respond by strengthening their offering and by seeking to retain their existing subscribers (ie a normal competitive response). Anticipation of such a competitive response from incumbents in the market might discourage entry.

5.63 A new entrant would also need access to content which consumers regard as the most important aspect of a pay-TV service (see paragraphs 5.24 and 5.25).

5.64 Entry using non-satellite delivery would involve similar issues to entry by satellite delivery. We noted that there could be some efficiencies and cross-selling opportunities if the new entrant was already involved in the supply of telephony and broadband services but, clearly, the two largest telephony and broadband suppliers, BT Retail and TalkTalk, had already entered the pay-TV market, albeit so far on a small scale.

Retailing via the platforms of existing pay-TV or FTA retailers

5.65 Retailing via the platforms of existing pay-TV retailers would require the platform owners to grant access. We noted that Sky's platform was required to be open to third party retailers, but other traditional pay-TV retailers' platforms were not.[56] Sky said that because its platform was open, any entrant had the option to retail its channel directly to a large addressable base (over 10 million households). Sky argued that this had two benefits for potential entrants: *(a)* it assured entrants of being able to reach a sizeable proportion of the UK population in the event that they were successful in acquiring rights; and *(b)* it gave them a strong bargaining position if they wished to negotiate a wholesale deal with Sky.

5.66 On the basis of the activities of those retailers which, currently or recently, had retailed their content on Sky's platform, it seemed to us that entry via Sky's platform was most plausible for an entrant with a narrow product range, eg a single channel or a group of channels. However, we noted that, in the past, this had not been a successful strategy by which to reach a large and sustainable number of subscribers; and we were not aware of any reason why it should become a more successful strategy for entry in the future.[57] In particular, it appeared to us that an entrant retailing over Sky's platform would always be at a disadvantage to Sky because Sky had

[53] See paragraph 5.38.
[54] See Appendix 5.1.
[55] In the UK, two satellite platforms were started in 1989/90. These merged to form Sky in 1990.
[56] See Appendix 5.2.
[57] See Appendix 5.2. Sky said that it would be erroneous to extrapolate from the fact that services retailed by third parties on Sky's platform were currently niche services, with small subscriber bases, to a view that this meant that it would not be feasible for a third party retailer to develop a significant subscriber base on Sky's platform (if it provided a more mainstream channel offering). We disagreed with this view because Setanta's mainstream UK channel offering was not successful and because of the views expressed to us by other retailers.

the primary relationship with its subscribers. In our view, wholesaling to Sky was likely to be more attractive to channel providers than retailing over Sky's platform, due to the costs and risks associated with reaching Sky's subscribers. We consider these issues further, specifically in relation to launching a service with FSPTW movie content, in Section 7.

5.67 Another possibility might be for a new entrant to retail via Freesat's platform. We were told that Freesat receivers might, in the future, have a facility for conditional access and that Freesat might offer access to a retailer of pay-TV content. Ofcom survey data suggested that, at the start of 2012, there were around 0.5 million homes using Freesat for their main TV (see Table 2.1 in Section 2), and there were likely to be some other homes which had at least one of their other TVs connected to a Freesat STB.[58] [✄] some existing Freesat users and a number of other consumers [✄] had expressed an interest in a Freesat proposition including some unbundled optional premium pay-TV services (ie without an enforced 'buy through' of basic channels). However, we did not see evidence of pay-TV providers generally having an interest in selling over the Freesat platform[59] and we judged that most Freesat customers were likely to have limited interest in pay TV given that Freesat customers had chosen a free TV service rather than a paid-for service in the first place. Overall, we did not believe that retailing via Freesat's platform on its own was likely to enable large-scale entry or expansion in pay TV, though we recognized that, in some circumstances, it may give some assistance to entry or expansion based principally on another platform or other forms of distribution such as OTT.

Expansion by existing smaller traditional pay-TV retailers

5.68 We considered the extent to which existing smaller traditional pay-TV retailers such as BT, TalkTalk and TUTV could expand, either by increasing their coverage of households which were able to connect to their services or by competing more strongly to attract subscribers in areas they already covered. It appeared to us that the main barriers to large-scale expansion by smaller traditional pay-TV retailers were the same as the main barriers to large-scale new entry, ie the high cost of acquiring new subscribers and the likelihood of a competitive response by existing suppliers (see paragraph 5.62).

5.69 We noted that BT started selling pay TV in December 2006 and, by May 2012, it had gained [✄] million pay-TV subscribers, representing a market share of [✄] per cent, while TalkTalk and TUTV [✄]. Paramount suggested that the key issues explaining BT's limited success in pay TV were the quality of broadband (which in Paramount's view was now changing) and BT's lack of sports content (which Paramount said had changed following the CAT's order in relation to Sky Sports 1 and 2).[60] On the former, BT provided us with data showing that, in September to December 2009, [✄] per cent of VOD requests failed due to low line speed or network errors (declining to [✄] per cent in the comparable months of 2011), while complaints about jittery VOD had been [✄] ([✄] per cent of BT Vision's subscriber base). On the latter issue, we noted BT's submission that, when it started to retail two Sky Sports channels, Sky's competitive response was significant (see paragraph 5.54). We agreed with Paramount that factors such as broadband quality and lack of sports content might have been among those which affected BT's penetration in pay TV; however, we did not believe that they were the only relevant factors, and the other factors we

[58] In early 2011, Freesat told us that over 1.8 million receivers had been sold since its launch.
[59] We noted that, recently, PictureBox had become available to Freesat subscribers with certain STBs and [✄].
[60] We noted that BT Vision had recently acquired the rights to show 38 Premier League games each season between 2013/14 and 2015/16.

had identified (the high cost of acquiring new subscribers, the likelihood of a competitive response by existing suppliers and access to content, see paragraphs 5.58 to 5.64) were likely also to have been relevant.

OTT pay-TV retailing

5.70 Over the last year of our inquiry, we have seen the launch in the UK of an SVOD-only service by Netflix and significant enhancements to the streaming service offered by LOVEFiLM. Both services distribute their content to consumers using the open Internet and have reached agreements with the manufacturers of many devices on which customers can access them. We discuss OTT pay-TV retailing and the extent to which it is a substitute for Sky Movies and for bundled packages of traditional pay TV in more detail in Appendix 4.2. In summary, based on *(a)* the number of subscribers achieved so far, *(b)* the content agreements they have secured, *(c)* the accessibility agreements they have reached, *(d)* their operations in other geographic and product markets, and *(e)* their plans for the future in the UK, our judgement was that both LOVEFiLM and Netflix should be regarded as large-scale entrants with the potential to affect competition significantly.

5.71 Nevertheless, the important questions for us were whether and how far this entry would succeed and its impact on competition in pay-TV retailing. In that respect, we considered the factors which might impede expansion as an OTT pay-TV retailer, and our views on these issues informed the weight we considered it appropriate to attach to this new entry in analysing our theory of harm. We considered in particular the potential impact of a competitive response to these new services (see paragraphs 5.155 to 5.157).

5.72 We noted that, by contrast with the sunk costs and risks associated with entry on or via a traditional pay-TV platform, OTT pay-TV retailers were likely to have substantially lower SACs than the traditional pay-TV retailers (see paragraph 2.144). As discussed in more detail in Appendix 4.2, we also considered that the barriers to switching to (and from) an OTT pay-TV retailer were likely to be lower than those associated with switching from a traditional pay-TV retailer.

5.73 We asked LOVEFiLM and Netflix to provide us with details of their SACs in the UK and their forecasts. Table 5.7 shows their responses.

TABLE 5.7 **Projected subscriber acquisition costs by OTT pay-TV retailers, 2012 to 2014**

	SAC £
LOVEFiLM*	[✂]
Netflix†	[✂]

Source: OTT pay-TV retailers.

*[✂] These are averages for all LOVEFiLM packages.
†[✂]

5.74 The lower average SACs of OTT pay-TV retailers reflected the fact that they did not provide proprietary STBs to their customers, whereas traditional pay-TV retailers did, usually funded by a subsidy which represented a [✂] part of their SACs. [✂] We noted [✂] Netflix was using Facebook as the channel through which consumers were encouraged to subscribe to its service in the UK. Notwithstanding these differences compared with traditional pay TV, we noted that the significant level of LOVEFiLM's and Netflix's planned marketing expenditure in 2012 and 2013 (see paragraph 5.55) was consistent with large-scale entry into pay-TV retailing.

5.75 Given that OTT entry had recently occurred, we were less concerned with the potential for future entry on an OTT basis into pay TV than with the ability of LOVEFiLM and Netflix to continue to expand (see paragraph 5.71). However, we considered whether the activities of LOVEFiLM and Netflix (and also Sky through Now TV) might be indicative of broader trends. It appeared to us that the recent development of the OTT services of LOVEFiLM and Netflix (and also Now TV) and the launch or expansion of several TVOD services (see paragraph 2.16) suggested that many companies perceived an increasing commercial opportunity to distribute movie content to consumers over the Internet. In this regard, we noted that LOVEFiLM and Netflix were likely to have some first-mover advantage as SVOD OTT suppliers focused on movies and previously-broadcast TV programmes (by virtue of their existing subscriber bases and investment in marketing) but we did not rule out further large-scale SVOD entry on an OTT basis (perhaps with a different focus (eg specialized content or possibly sports content)). Notwithstanding this possibility, we did not see any evidence to suggest that further significant entry on this basis was likely in the foreseeable future.

Innovation in pay TV

5.76 Innovation is a potentially important dimension of competition. During Ofcom's investigation into pay TV, Sky submitted that UK consumers of pay-TV services were well served and the UK was one of the leading countries in Europe in terms of the introduction and take-up by consumers of innovative new products and services in the audiovisual sector.[61] Ofcom said that the record of innovation in the UK was strong and that Sky had played a central role in developing innovative services.[62]

5.77 Appendix 5.3 (taken from Ofcom's Pay TV Statement) summarizes innovative developments in the UK pay-TV market between 1997 and 2010. Ofcom said that a variety of different platforms had been responsible for the introduction of different technologies into the UK. Ofcom noted, as examples:

(a) TiVo was first to offer PVRs in the UK in October 2000, with the launch of its eponymous device that worked with satellite, terrestrial and cable TV. It entered the UK with a marketing agreement with Sky, and a year later Sky launched its own PVR product, Sky+.

(b) VOD services were first launched in the UK by Homechoice and Kingston Interactive Television in 1999.

(c) HDTV was first launched in the UK at the end of 2005 on the cable network of Telewest. Sky launched its HDTV service in May 2006, and HDTV was made available to customers of the ntl cable franchise in November 2006.

5.78 Ofcom said that Sky had been instrumental in driving the adoption of several important innovations, and noted that this was the case even where it had not been responsible for the initial introduction of the innovation. Ofcom noted, for example, that Sky had not been the first to launch either a PVR or HD, but it was Sky that had turned both of these innovations into mass-market successes. Ofcom also recognized that those innovations which had been popularized by Sky tended to be adopted subsequently on other platforms (eg the PVR). Ofcom noted that, where Sky had not driven

[61] Study produced for Sky by PWC during Ofcom's Pay TV Review.
[62] Pay TV Statement, paragraph 8.182. For example, Sky created the first satellite service in the UK in 1989, with two channels being distributed.

the take-up of a new service, other platforms had been less successful in promoting it.

5.79 Ofcom recognized that Sky had a continuing incentive to innovate in order both to grow the market (ie by selling new services to its existing consumers, or by attracting new consumers to its platform from FTA platforms such as Freeview), and to attract new consumers to its platform from other platforms. However, Ofcom also noted that Sky's position as a large incumbent meant that it would not innovate where it might cannibalize revenues from existing subscribers, and would typically only engage in innovations which tended to favour its own platform.

5.80 We agreed with Ofcom that Sky's propensity to innovate was likely to be affected by the impact of its innovations on its own business, ie Sky would have less incentive to innovate if its innovations adversely affected its existing business and, in these circumstances, it may not bring new services or facilities to market either at all or as quickly. As a possible example of this effect, we noted that Sky had had an OTT service for some time, branded Sky Go (previously Sky Player), but this service had been aimed principally at existing subscribers on Sky's satellite/IPTV platform. Sky had offered stand-alone subscriptions to Sky Go (ie without requiring a subscription to Sky's DTH satellite platform), which in principle had provided consumers with an alternative way of viewing pay-TV content but, despite a different cost structure (as Sky did not need to provide satellite dishes or STBs to subscribers who viewed content only over the Internet and had paid for the devices they used to do so), Sky had priced stand-alone Sky Go products at similar prices to its full service products.[63] [✂][64,65] We also noted that, in September 2010, there were [✂] Sky Player subscribers. It appeared to us that Sky Go was an innovative, additional service offered by Sky, but the pricing structure which Sky had adopted for it could have been influenced by a desire not to cannibalize its existing subscriber base.

5.81 More recently, Sky launched its new OTT service, branded Now TV, which offers Sky Movies at an unbundled price of £15. This price is similar to the incremental retail price of dual movies when bought without Sky Sports (£16) as part of a traditional pay-TV package; however, it is a much lower price than that which a customer who only wants Sky Movies previously paid.[66] It appeared to us that Sky's launch of Sky Movies as an unbundled OTT product on Now TV before any other content was offered on the service was, at least in part, a response to the competitive threat from LOVEFiLM and Netflix.[67] In this respect, Sky was not the innovator of these new services but the follower.

5.82 BT told us that it recognized that Sky had led in the marketing of certain innovative services in pay TV in the UK, such as PVRs and HDTV, which had played a significant role in their mass-market adoption. However, BT also said that Sky itself had not been responsible for these innovations. BT said that Sky had simply adopted and marketed others' innovations where it had recognized a commercial opportunity in doing so and had used them to increase the costs of entry for new entrants, for example by setting a market standard in which PVRs were provided without charge, and HDTV had to be included within the channel proposition.

[63] For example, between September and December 2010, a Sky Player subscription for the Sky Player entertainment and movie packs was £32. This compared to £27 for a single entertainment pack and a single movies pack on the main Sky service (the main service single movies pack does not, however, include Sky Premiere) and £35 for a single entertainment pack and the dual movies pack.
[64] Sky told us that [✂].
[65] [✂]
[66] See paragraph 2.94.
[67] See Appendix 4.2

5.83 Virgin Media said that we had overstated the degree of innovation. It said that Sky had innovated only in ways which *(a)* favoured the technological capabilities of the satellite platform; and *(b)* limited the cannibalization of its core revenue base. Virgin Media said that Sky had restricted the supply of key sports and movies content, limiting the ability of other retailers to innovate and reducing their incentive to do so. Virgin Media added that [✂].

5.84 While we saw some merit in the points made by BT and Virgin Media, we did not accept that we had overstated the degree of innovation. We continued to agree with Ofcom's judgement that the record of technical innovation in pay TV generally in the UK had been strong and that Sky had played a central role.

Price levels and trends

5.85 In March 2012, basic pay-TV packages with Sky cost between £20.00 and £25.00 per month and with Virgin Media cost between £12.50 and £30.50 per month, depending on the package taken. The incremental price of a dual movies pack (over and above basic pay-TV) was £16.00 per month with Sky and £19.50 per month[68] with Virgin Media.[69] Consequently, the price of a package of basic pay TV plus dual movies was between £36.00 and £41.00 per month with Sky and between £32.00 and £50.00 per month[70] with Virgin Media. These prices did not include major pay-TV sports channels (except that Virgin Media's maximum (XL) basic pay-TV pack includes ESPN).[71]

5.86 In March 2012, BT charged £12.50 per month for its pay-TV 'unlimited' package which includes SVOD movies[72] and TV content and ESPN's sports channel. However, a subscription to this package also requires subscribers to take broadband and telephony from BT, and thus its price is not necessarily comparable with those quoted in the previous paragraph as subscribers taking broadband and telephony from Sky or Virgin Media may benefit from 'triple play' discounts.

5.87 In March 2012, TUTV charged £13.99 per month for its 'TV favourites' pack and an additional £5.00 for including movies from PictureBox.[73]

5.88 As regards OTT services, in March 2012 LOVEFiLM charged £4.99 per month for its SVOD-only service and Netflix charged £5.99 per month for its service. The PictureBox SVOD service was also available OTT at a price of £4.99 per month.[74]

5.89 Figures 5.4 to 5.6 show trends in the prices charged on the Sky and Virgin Media platforms for the main Sky Movies products (single movies, dual movies, and dual movies with dual sports). The higher prices in Figures 5.4 to 5.6 show the total package prices (including access to the relevant platform and basic channels), while the lower prices show the incremental retail prices for the movies product (calculated as the total package price less the basic package price).[75] The charts show inflation-adjusted prices assuming that the subscriber takes the maximum package of basic channels (for most of the period this was all six entertainment mixes for Sky and the

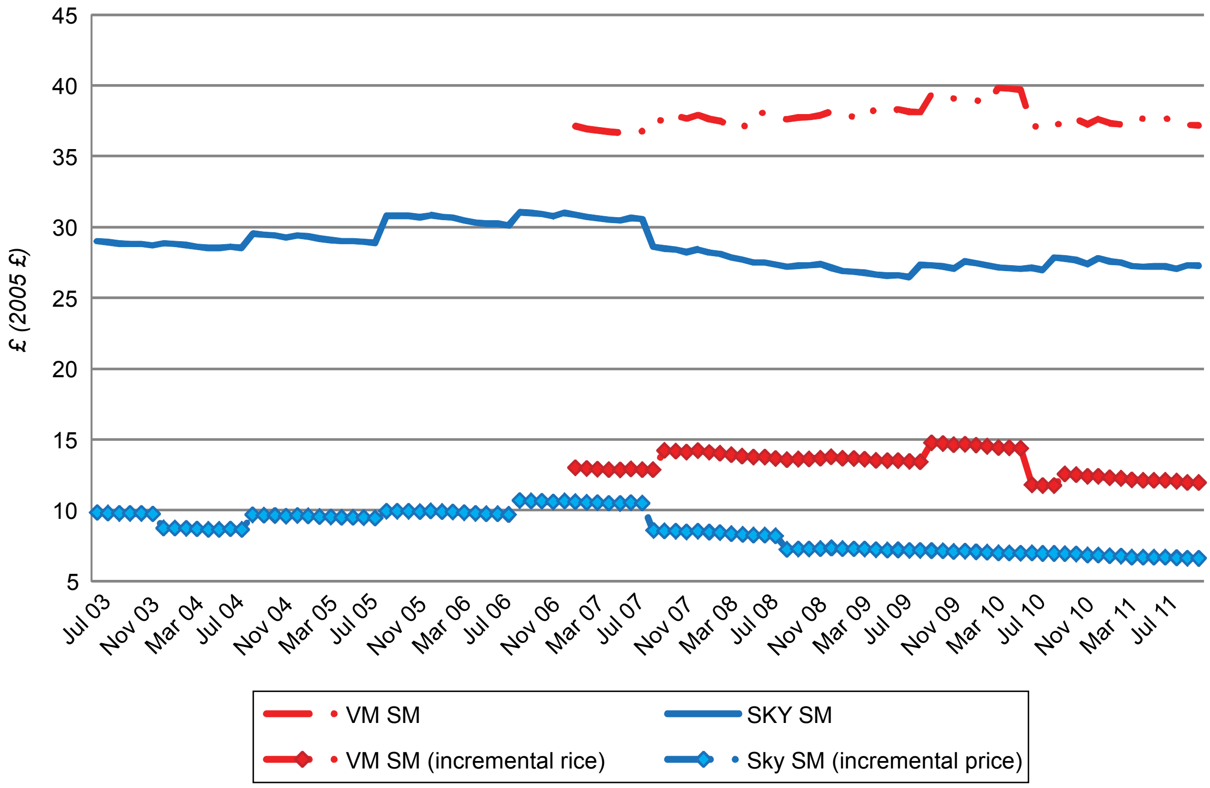
[68] £28.00 for subscribers to Virgin Media's M-pack.
[69] Various other options are available (see Table 2.2). The effective price for pay-TV packages may be lower due to 'triple play' discounts. However, these tend not to affect the incremental price of Sky Movies.
[70] Not including subscribers to Virgin Media's M-pack.
[71] Sky's Entertainment Extra pack and Virgin Media's M+, L and XL packs include At the Races and Eurosport channels.
[72] BT's Vision Film service currently offers around 150 movies at any point in time (see Appendix 4.12).
[73] We have not quoted TalkTalk's prices as in March 2012 it was no longer offering pay TV to new subscribers.
[74] The PictureBox service offers 28 movies at any point in time.
[75] We discuss Sky's incremental retail prices further in Appendix 8.1.

XL bundle for Virgin Media) as these packages were bought by the majority of Sky Movies subscribers.[76]

5.90 In the period for which we had prices for both retailers (ie since January 2007), Virgin Media's prices were higher than Sky's prices, although the difference was smaller for the dual movies/dual sports product than for single movies and dual movies.[77]

FIGURE 5.4

Single movies prices by retailer: package price and incremental product price

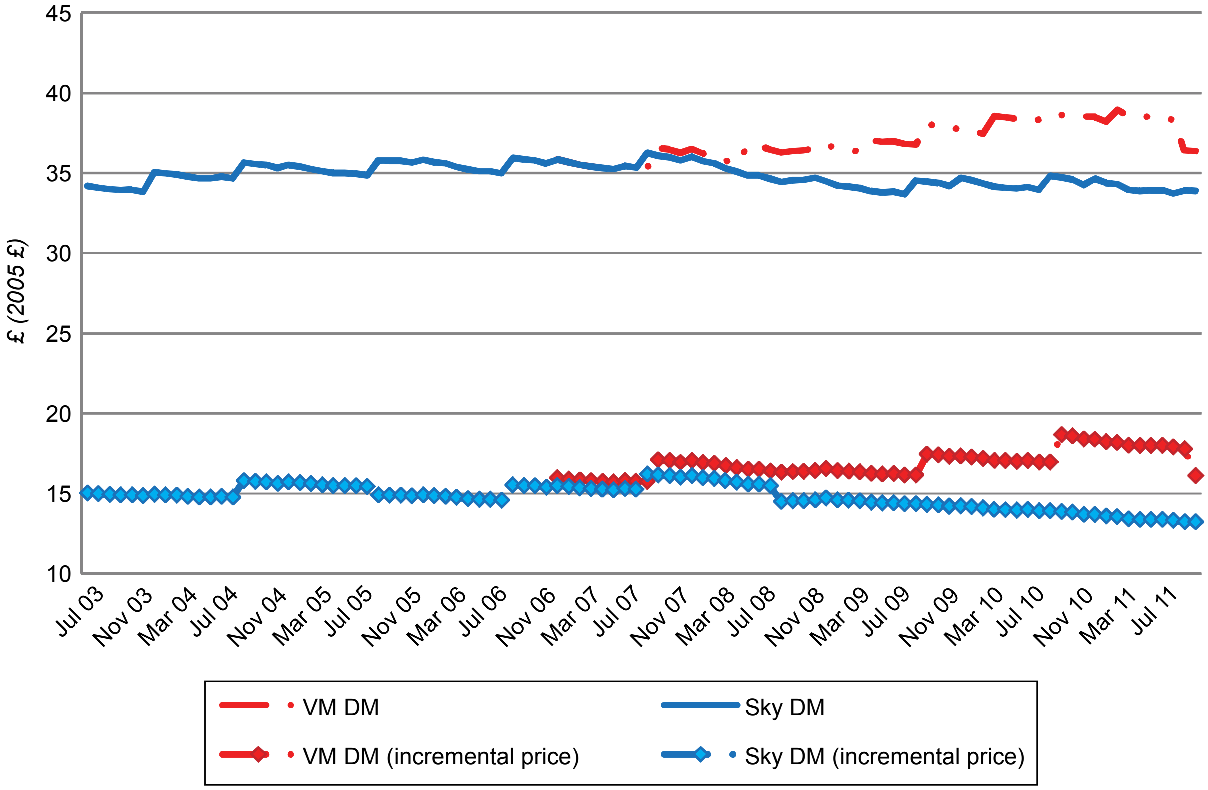


Source: Price data provided by the parties.
Note: For Sky, package and incremental prices refer to the prices paid by subscribers who take the maximum basic package. For Virgin Media, the prices refer to the price paid by subscribers of TV XL ([✂] per cent of Virgin Media subscribers take the XL package) and exclude the price paid for the phone line. Data for Virgin Media was not available prior to January 2007. Prices are adjusted for inflation and expressed in 2005 money. The monthly CPI provided by the ONS has been used for the inflation adjustment.

[76] As nearly all Virgin Media TV subscribers take a phone line, the Virgin Media prices shown include a discount for taking both TV and phone line.
[77] The step changes shown in Figures 5.4–5.6 arise because prices are changed infrequently, usually no more than once per year. [✂]

FIGURE 5.5

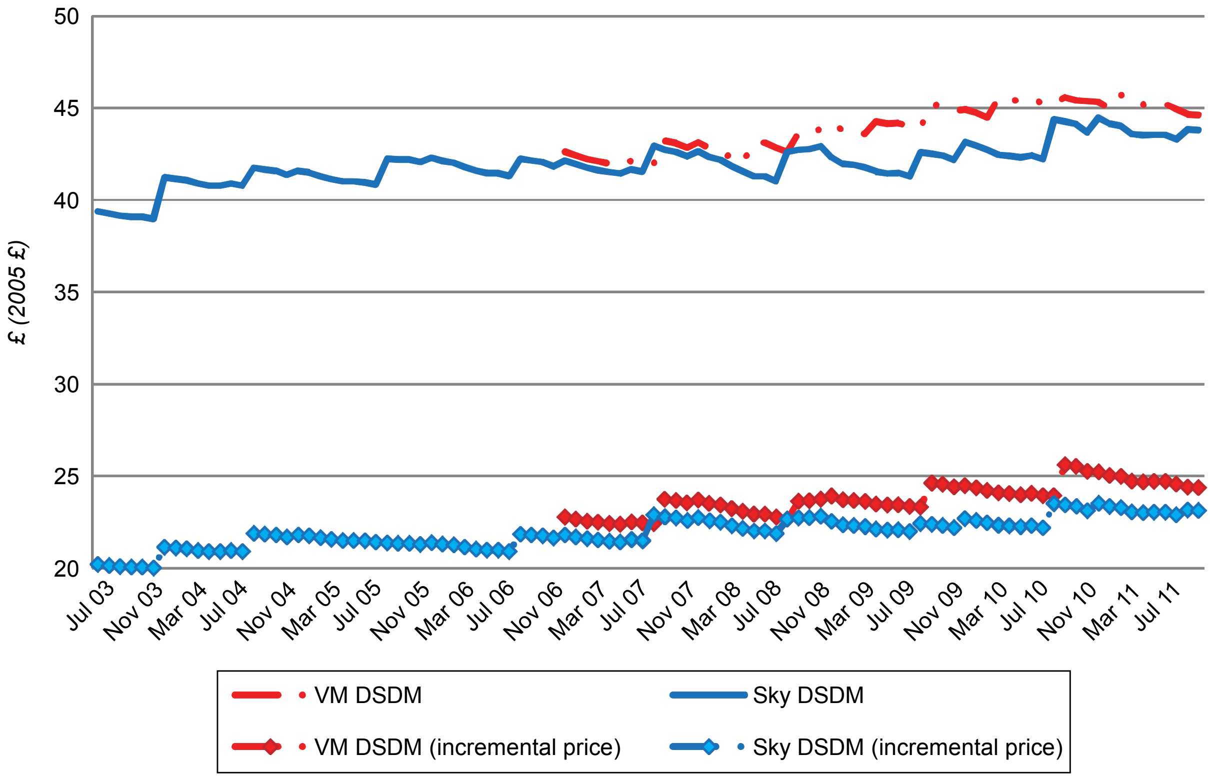
Dual movies prices by retailer: package price and incremental product price



Source: Price data provided by the parties.
Note: For Sky, package and incremental prices refer to the prices paid by subscribers who take the maximum basic package. For Virgin Media, the prices refer to the prices paid by subscribers of TV XL ([✂] per cent of Virgin Media subscribers take the XL package) and exclude the price paid for the phone line. Data for Virgin Media was not available prior to January 2007. Prices are adjusted for inflation and expressed in 2005 money. The monthly CPI provided by the ONS has been used for the inflation adjustment.

FIGURE 5.6

Prices for subscribers taking dual movies/dual sports product: package and incremental prices



Source: Price data provided by the parties.
Note: For Sky, package and incremental prices refer to the prices paid by subscribers who take the maximum basic package. For Virgin Media, the prices refer to the prices paid by subscribers of TV XL ([✂] per cent of Virgin Media subscribers take the XL package) and exclude the price paid for the phone line. Data for Virgin Media was not available prior to January 2007. Prices are adjusted for inflation and expressed in 2005 money. The monthly CPI provided by the ONS has been used for the inflation adjustment.

5.91 Over time, Sky's incremental prices for its single and dual movies products have declined in real terms, though this is not the case for the dual movies/dual sports product. [✂] As shown in Table 5.8, [✂], during this period, Sky's incremental price for the dual movies product dropped by less than £1 per subscriber. Sky's incremental retail price for the single movies product dropped more markedly but there are relatively few subscribers taking the single movies packs.[78]

[78] In July 2011 only about [✂] per cent of Sky Movies subscribers took the single movies pack compared with [✂] per cent who took the dual movies pack (with or without sports packs).

TABLE 5.8 **Comparison of cost of Sky's movie rights with incremental prices for Sky's movie products at 2005 prices, 2003/04 to 2009/10**

Year*	Cost of movie rights†		Incremental price of dual movies (Sky)		Incremental price of single movies (Sky)‡	
	£ 2005 per sub	Change since 2003/04	£ 2005 per sub	Change since 2003/04	£ 2005 per sub	Change since 2003/04
2003/04	[✂]		14.90		9.25	
2004/05	[✂]	[✂]	15.51	0.61	9.44	0.19
2005/06	[✂]	[✂]	14.93	0.03	9.82	0.57
2006/07	[✂]	[✂]	15.27	0.37	10.45	1.20
2007/08	[✂]	[✂]	15.85	0.95	8.79	–0.45
2008/09	[✂]	[✂]	14.72	–0.18	7.43	–1.81
2009/10	[✂]	[✂]	14.20	–0.70	7.10	–2.15

Source: CC calculations based on information from Sky and Virgin Media, and CPI published by ONS.

*12 months from 1 July to 30 June.
†The cost of Sky's movie rights in £ 2005 per subscriber was calculated by revaluing Sky's total payment for movies for changes in the CPI and dividing by the total number of Sky Movies subscribers (on both Sky and cable platforms).
‡The single movies pack includes half or fewer of the Sky Movies channels. Hence changes in the price of the single movies product are not directly comparable with changes in the cost of the rights per subscriber.
Note: This table does not include the incremental price of the dual movies/dual sports product as this is affected by the cost of sports as well as movies rights.

Profitability of Sky

5.92 An important indicator of the extent of competition in a market is the level of profit of the companies involved. We would expect competition to put pressure on profit levels so that they move towards the cost of capital in the medium to long term. Where profits have been persistently in excess of the cost of capital for companies that represent a substantial part of the market, this is likely to indicate limitations in the competitive process and is consistent with the presence of features that prevent, restrict or distort competition. The amount by which profits exceed the cost of capital is also important as, where companies have earned profits that have persistently and substantially exceeded the cost of capital, this will tend to indicate a more significant competition problem than a situation in which the gap is persistent but smaller.

5.93 As Sky is the sole provider of movie channels with major studio FSPTW content in the UK, and is also the largest retailer of pay-TV movie channels in the UK, we focused our profitability analysis on Sky. In Appendix 5.4, we set out in detail our analysis of the aggregate profitability of Sky and our consideration of the disaggregated profitability of parts of Sky's business. Here we present a summary.

Aggregate profitability analysis

5.94 Our aggregate profitability analysis considered Sky's UK pay-TV operations and, as far as possible, excluded its other operations. In this part of the analysis we did not attempt to disaggregate Sky's retail pay-TV activities from other activities undertaken by Sky (such as its broadcasting of pay-TV channels). Sky did not perform any such disaggregation itself and therefore we considered that such a disaggregation would be too heavily reliant on a number of assumptions to be meaningful.

5.95 We assessed Sky's aggregate profitability using a truncated internal rate of return (TIRR) approach, which measured the internal rate of return over a specific period during the lifetime of an economic activity. We then compared Sky's profitability over a number of five-year periods with a weighted average cost of capital (WACC) for the same periods. We used return on capital employed (ROCE) calculations as a cross-check to the TIRR approach.

5.96 We accepted that there were some limitations to a TIRR approach in that, like other approaches to measuring profitability, it required assumptions and judgements to be made. Both ROCE and TIRR calculations are dependent on the quality of the inputs used and it is particularly important that the appropriate asset valuations and cash flows are identified. However, we found that a TIRR, suitably cross-checked to a ROCE-based assessment of profitability, was a reasonable way to assess Sky's profitability for the purposes of our investigation because it reflected the inflows and outflows of cash, changes in asset values over time and the time value of money. It therefore reflected the way in which companies make investment and entry/exit decisions.

5.97 We considered using other methodologies to assess Sky's profitability, for example assessing Sky's total shareholder return or benchmarking Sky's return on sales against other companies. However, we found that these alternative approaches suffered from significant limitations which meant that they were unlikely to be informative for the purposes of a competition assessment of whether Sky had achieved excess profits.

5.98 As part of Ofcom's pay-TV investigation, Ofcom asked Oxera to conduct a detailed profitability analysis of Sky. Oxera's model produced TIRR results and used ROCE figures as a cross-check. Having tested the robustness of Oxera's model, we decided to use it as a starting point for our aggregate profitability modelling rather than to start afresh. We examined each aspect of Oxera's analysis and considered when doing so whether we would have adopted a different approach or used different assumptions. We formed our own base case, making adjustments to Oxera's analysis for those aspects which we found we would have done differently.

5.99 Following publication of our August 2011 provisional findings, Sky provided us with a model prepared by Sky (with input from PricewaterhouseCoopers (PwC)) (the 'Sky/PwC model'). Like Oxera's model this produced TIRR and ROCE figures, but it also included certain differences, as set out in Appendix 5.4. We found that the Sky/PwC model was a slight improvement on Oxera's model because PwC had been able to make refinements in the estimation of the subscriber base.[79] However, we found that, given the same input assumptions, the results produced by the Sky/PwC model were very similar to those produced by Oxera's model as adjusted by us in our August 2011 provisional findings. Given these relatively small differences and rather than use both models, we subsequently used the Sky/PwC model, with our own assumptions, in order to derive our base case TIRR and ROCE estimates of Sky's profitability. We explain below how our assumptions differed from those of Oxera and Sky/PwC.

5.100 A TIRR requires the asset base to be valued at the start and end of the period as these represent the first and last cash flows; and a ROCE calculation requires a valuation of the asset base in each year for which it is being calculated. The appropriate valuation for the assets is the modern equivalent asset approach, which identifies the lowest cost of purchasing the assets today which can deliver the same set of services as the existing assets (ie the investment required by a new entrant to replicate the services on which the return is earned). High returns on this basis should provide a signal for market entry.

5.101 As asset valuations are particularly important in assessing profitability using TIRR and ROCE, we considered carefully which assets should be included and at what

[79] The other main differences between the Sky/PwC model and our evaluation of Sky's profitability in our August 2011 provisional findings were the inclusion of additional intangible assets (see paragraph 5.105), a different WACC (see paragraph 5.106) and reinvestment of positive cash flows at the average WACC (see Appendix 5.4, paragraphs 176–181).

values. In particular, we noted the presence of significant intangible assets which related to Sky's business but which were not reflected on Sky's balance sheet. The criteria we used to determine which assets to include were as follows:

(a) the asset must be derived from a cost incurred, primarily to obtain earnings in the future;

(b) this cost must be additional to those necessarily incurred at the time in running the business; and

(c) the cost must be identifiable as an asset separate from any that arise from the general running of the business.

5.102 These criteria were originally set out in the CC's report on the supply of banking services to small and medium-sized enterprises,[80] and were subsequently reviewed by Sir Bryan Carsberg in a report for HM Treasury.[81] The Carsberg report broadly concurred with the conclusions of the CC's report and said that 'the framework adopted by the Commission is sound and would be accepted by most independent experts'.[82]

5.103 We considered alternative criteria put forward by Sky and PwC for recognizing intangible assets. These criteria allowed, among other things, for the possibility of including costless assets. We valued intangible assets based on their cost because we were concerned that any approach which required valuations to be based on expected future earnings embedded the expectation of future profits in the asset base and hence introduced a circularity into the assessment. We considered Sky's proposed criteria for intangible asset recognition but, for the reasons set out more fully in Appendix 5.4, we did not believe they were suitable for a competition assessment.

5.104 Having assessed possible intangible assets to include in the asset valuation on the basis of the above criteria, we recognized and took account of only Sky's subscriber base. This approach was different from that proposed by both Oxera and Sky/PwC: Oxera had also recognized an intangible asset relating to Sky's contractual obligations; and Sky/PwC had included intangible assets for contractual obligations (consisting of sports rights and movie rights), brand, relationships with third party engineers, third-party channel supply contracts and a skilled workforce. Our detailed reasons for rejecting the inclusion of these intangible assets in our asset valuation are set out in Appendix 5.4. In summary, we judged that none of them met the criteria for intangible asset recognition set out in paragraph 5.101.

5.105 The differences in intangible asset recognition were the main differences between the assumptions used by Sky/PwC and our base case assumptions.[83] However, for some of the intangible assets proposed by Sky, we conducted a sensitivity analysis to see what effect including them would have had on our assessment.[84]

5.106 Oxera estimated a pre-tax nominal WACC for Sky which it used as a comparator to its estimate of the TIRR (it used the capital asset pricing model to estimate the cost of equity). We reviewed Oxera's estimates of the WACC and found them to be reasonable. The Sky/PwC model used a WACC which, for the period following 2000 (which was the period of particular concern to us), was similar to that used by

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[80] *Supply of banking services by clearing banks to small and medium-sized enterprises,* March 2002.
[81] *Report on certain issues arising out of the report by the Competition Commission on the supply of banking services by clearing banks to small and medium-sized enterprises.*
[82] Carsberg report, paragraph 12.
[83] See the footnote to paragraph 5.99.
[84] See paragraph 5.108 and Table 5.9 below.

Oxera.[85] We used Sky/PwC's estimate of the WACC, not because we believed it to be superior to Oxera's estimate, but because both estimates were reasonable and there was little difference in the figures for the period since 2000.

5.107 We compared the results of our TIRR and ROCE analysis with Sky's WACC to estimate a 'profitability gap' (the difference between Sky's TIRR/ROCE and its WACC). In our base case, we found a profitability gap of [✂] per cent for the period 2007 to 2011 using a TIRR methodology. We also calculated Sky's ROCE over this period and found that the results were consistent.[86] On this basis, it appeared to us that, over the period 2007 to 2011, Sky had achieved profits which were both persistently and substantially in excess of its cost of capital.

5.108 We conducted a sensitivity analysis to assess the effect on TIRR of changing some of the assumptions in the model. Table 5.9 shows our base case assessment of Sky's profitability and the incremental effects of the sensitivities we considered (due to the nature of the model the cumulative effect of all the adjustments was not simply the sum of the incremental effects).

TABLE 5.9 **Our base case and the incremental effects on the profitability gap of revising certain assumptions**

Profitability gap based on TIRR and average WACC over TIRR period	*Reduction from change in assumption*	*2007–2011 profitability gap %*
Our base case		[✂]
Contractual obligations included as an asset	[✂]	[✂]
Skilled workforce included as an asset	[✂]	[✂]
Cumulative effect of these two changes	[✂]	[✂]

Source: CC analysis based on Sky/PwC model.

5.109 We judged that none of the sensitivities we considered reduced the profitability gap sufficiently to change our conclusions.

5.110 We did not believe that the other intangible assets included in Sky/PwC's base case should be included even as a sensitivity because they were even further from meeting our criteria for recognition as an intangible asset than those we had considered.

5.111 We considered Sky's profitability over longer historical periods and found that Sky had earned profits in excess of its cost of capital for many years. Sky's profitability gap using rolling five-year TIRRs starting in periods from 2002 to 2007 was more than [✂] per cent in each period. We calculated Sky's ROCE over the period 2002 to 2011 and found that the results were consistent with the TIRR analysis.

5.112 We also considered Sky's forecast profitability. We reviewed Sky's public statements and forecasts and numerous analysts' reports. This evidence indicated that Sky's profitability was likely to increase in the future. Furthermore, it appeared to us that Sky's large and stable customer base, with increasing revenue per customer, meant that Sky was likely to face lower demand risk and therefore a lower cost of capital in the future. This evidence suggested that, even at the same level of profitability, Sky's profitability gap was likely to increase.

5.113 Based on these findings, we found that: *(a)* Sky had achieved profits which had been both persistently and substantially in excess of its cost of capital over the period 2007

[85] A full description of both calculations is in Appendix 5.4, Annex A.
[86] Appendix 5.4, Table 9, sets out our base case results for TIRR for five-year periods beginning in 2002 to 2007 and Table 10 sets out the ROCE on an annual basis from 2002 to 2011.

to 2011; *(b)* these excess profits had persisted on a rolling TIRR basis since 2002–2006 and on a ROCE basis for the ten years since 2002; and *(c)* these excess profits for the whole of Sky's UK pay-TV business were likely to persist into the future. Notwithstanding these findings, we noted that Sky's future profitability would depend on the strength of competition in the pay-TV retail market and, in this context, we noted that OTT competition may well exercise an increasing constraint on packages of traditional pay TV in the future.[87]

5.114 We recognized that it was possible for a company to earn profits in excess of its cost of capital within a competitive market particularly where significant investment risks had been taken. However, we would not expect such profits to persist for a significant period of time. Although we recognized that Sky had taken significant risks in the past, we found that its most risky investments were over ten years ago. The evidence we saw in relation to Sky's recent investments (for example in Sky+ and HDTV) suggested that *(a)* Sky believed itself capable of managing the associated risks; *(b)* the costs were largely scalable and within Sky's control; and *(c)* the payback periods were relatively short with positive returns expected in most cases from the outset. For these reasons, it appeared to us that Sky's profitability could no longer be explained by the risk of its investments.

Disaggregated profitability analysis

5.115 In addition to assessing Sky's aggregate profitability, Ofcom (and Oxera on behalf of Ofcom) also assessed Sky's disaggregated profitability. This included disaggregated analysis of Sky's movies business. We reviewed this analysis, and conducted our own analysis of Sky's disaggregated costs. We also reviewed some internal evidence from Sky. We found that we needed to treat the conclusions of this disaggregated analysis with caution because of the sensitivity of the results to the assumptions made. Therefore, we placed less weight on the disaggregated analysis and more on the aggregate profitability analysis. However, taking all the aggregated and disaggregated profitability evidence together, our assessment was that the profitability gap calculated for Sky overall was unlikely to overestimate the profitability of Sky's movie activities in the periods we considered.

5.116 We also considered whether we could form a view on the likely profitability of Sky's movie activities in the future. However, our forward-looking assessment of Sky's profitability related only to its entire business, being based on both analyst and management comments on the company's overall prospects (see paragraph 5.112). Therefore, we had little basis to form a view on the future profitability of Sky's movie activities alone. Furthermore, in this regard, we noted that the past profitability of Sky's movie activities may not be a reliable guide to its future profitability, in particular given the changes in recent months in the competitive landscape in relation to movie services on pay TV (see paragraphs 5.152 to 5.157).

Assessment of effectiveness of retail competition

5.117 We now set out our assessment of the effectiveness of retail competition in the pay-TV market.[88] First we discuss structural aspects of the market and then we discuss outcome measures.

[87] See Appendix 4.2 and paragraph 5.153.

[88] Our assessment covered the factors set out in our guidelines (CC3—Part 3 covers the assessment of competition) to the extent we considered them to be relevant to the pay-TV retail market.

Market structure

5.118 The number of firms competing in a market is a basic measure of structure that is relevant to competition. In general, and at least to some extent, rivalry is likely to be stronger the more companies there are competing for customers' business.

5.119 In the pay-TV retail market, there are two long-established and substantial traditional pay-TV retailers (Sky and Virgin Media), and three companies which started offering traditional pay-TV services later (BT Vision, TUTV and TalkTalk TV) and which have so far achieved a relatively small share of the market.

5.120 In the course of our inquiry there was significant OTT entry by LOVEFiLM and Netflix and both companies acquired a substantial number of subscribers in a short period.[89] However, at the time of our report, the impact of these services on the pay-TV retail market in terms of acquired market share was still limited.[90] Therefore, our view remained that, at that time, the main competitors in the pay-TV retail market were Sky and Virgin Media, and the other smaller competitors provided only a limited constraint.

5.121 Nevertheless, as discussed in Appendix 4.2, we expected OTT services to become closer substitutes for traditional pay TV over time due to factors such as: *(a)* the increasing adoption of Internet-connected TVs and/or STBs (improving convenience and reducing dependence on games consoles as a means of accessing OTT services on households' main TV); *(b)* the increasing availability of broadband, and faster broadband; *(c)* an increasing awareness of OTT among less technologically-aware households, in particular following the launch of services which 'popularize' OTT services, eg YouView; *(d)* social factors, including interaction on social media; and *(e)* an improving range and quality of content on the existing OTT services of LOVEFiLM and Netflix (ie under existing licensing agreements). In the light of these factors, we expected the constraint on traditional pay-TV retailers from new entrant OTT suppliers, currently LOVEFiLM and Netflix, to increase.

Market shares and concentration

5.122 In assessing market structure, competition authorities sometimes have regard to market shares and concentration measures.

5.123 A market share above 30 to 40 per cent is sometimes regarded by competition authorities as sufficient to give a firm market power.[91] Precise market shares among pay-TV retailers depend on the method of calculation but our estimates suggested that Sky's market share was well above 30 to 40 per cent, indeed it has been consistently above 60 per cent for several years.[92]

5.124 A market with an HHI of concentration above 2,000 to 2,500 is often regarded by competition authorities as highly concentrated.[93] Our estimates suggested that the HHI for pay-TV retailing was well in excess of this figure, indicating that it was a

[89] See Appendix 4.2.
[90] The OTT entry by LOVEFiLM and Netflix was particularly relevant to the provision of pay-TV movies services, which we consider in Appendix 4.2 and Section 6.
[91] These figures are mentioned in the recent CC/OFT merger assessment guidelines (CC2).
[92] See paragraphs 5.16–5.19.
[93] CC2 suggests that the OFT may regard HHI values above 2,000 as highly concentrated. The US horizontal merger guidelines (see www.ftc.gov/os/2010/08/100819hmg.pdf) state that, based on their experience, the agencies (DoJ and FTC) generally classify markets into three types: unconcentrated (HHI below 1,500), moderately concentrated (HHI between 1,500 and 2,500) and highly concentrated (HHI over 2,500).

highly concentrated market. Sky pointed out that pay-TV retailing was also highly concentrated in many other countries, which we acknowledged.[94]

5.125 As well as current market shares and the level of concentration, changes in market shares may also be relevant to assessing competition. If the leading firm changes over time, this may suggest that no firm can achieve a position that is beyond challenge and that competition may be stronger than implied by indications from an individual year. However, we found that the overall market structure for retail pay TV in the UK (with Sky being the leading company followed by Virgin Media) had stayed broadly the same since pay TV started to be offered on a significant scale in the early 1990s. The market shares of Sky and Virgin Media had changed somewhat over time (from around 2000, Sky had gained market share from Virgin Media, reflecting some degree of competition between them), but the overall balance of their positions had been unchanged.[95]

5.126 Sky pointed out that its platform was available to twice as many homes as Virgin Media's and its market share in areas where Virgin Media's platform was available was lower than its overall market share. Based on Sky's data, we estimated that, in 2010, about [✂] per cent of pay-TV subscribers in areas where Virgin Media was available were with Sky, compared with [✂] per cent who were with Virgin Media.[96] Sky said that such outcomes indicated that Sky and Virgin Media were closely matched competitors and that national market shares were not relevant. We disagreed. We were considering a national market, where pay-TV retailers' offers were made to consumers on a national basis. The constraint that Virgin Media exerted on Sky was limited by the fact that its share of subscribers was zero in around half the country. Furthermore, if Sky and Virgin Media were closely-matched competitors with national pricing, we would have expected Virgin Media's share of subscribers in areas where its platform was available to have been greater than that of Sky (to make up for the fact that its share was zero in other areas).[97] In our view, the fact that Sky's share was greater than 50 per cent even in areas where Virgin Media was available was a reflection of Sky's competitive strength.

Product differentiation and switching

5.127 High concentration may not always imply weak competition. In some circumstances, there may be vigorous competition even when there are a very small number of rivals (for example, this may be the case where, among other things, firms offer similar products, are unable to coordinate their offerings and are not capacity constrained). While we saw no evidence that pay TV was characterized by coordination or capacity constraints, there was substantial differentiation between products in the pay-TV retail market (see paragraphs 5.20 to 5.26).

5.128 The different pay-TV retailers can reach differing proportions of UK properties. For example, Virgin Media's network extends to only about half of UK households, while

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[94] Sky said that there would be few consumers in the world served by a pay-TV sector that had an HHI below 2,000–2,500, the range regarded as indicating a 'highly concentrated market'. By way of example, Sky added that PwC's analysis of pay-TV services available in other European countries had found that European consumers rarely had more than three different pay-TV services available to them; most had a choice of two pay-TV retailers.
[95] See paragraphs 5.16–5.19.
[96] The Virgin Media area market shares were our estimates for calendar year 2010 using Sky data for subscribers of Sky and Virgin Media, but including an estimate for pay-TV retailers other than Sky and Virgin Media.
[97] In these hypothetical circumstances, we would have expected Virgin Media's offer to have reflected the fact that it faced competition from Sky in all areas where its service was available; with the result that, in those areas where Virgin Media was available, its offer would have been attractive to more subscribers than Sky's offer. We would have expected Sky's offer to have reflected both the relatively stronger competitive constraint it faced in areas where Virgin Media was available and the relatively weaker competitive constraint it faced in other areas.

there are also limits to the properties Sky can serve.[98] The effect of this limited overlap in coverage is similar to product differentiation because it means that Sky and Virgin Media do not compete directly for all subscribers.

5.129 As well as differences in geographical coverage, pay-TV retailers are differentiated by the quality and range of content and facilities they offer. Due to technology constraints, some traditional pay-TV retailers (in particular those relying on DTT) had been unable to offer the full range of linear content offered by Sky and Virgin Media and had thus been unable to compete directly for all subscribers.[99] The full range of linear content is also not relevant to OTT services, which operate via a different business model. However, even with regard to traditional pay-TV, we did not assume that effective competition necessarily required all pay-TV retailers to offer the same content; indeed, we recognized that competing to acquire content was in principle an aspect of competition between pay-TV retailers.[100]

5.130 Also relevant was that, due to switching barriers associated with perceived 'hassle' and subscriber inertia (see paragraph 5.43), we found that competition to date had been focused on a subset of subscribers, ie those new to pay TV and existing pay-TV subscribers willing to switch retailers. This meant that, over a given period, a reduction in price by one supplier had the potential to attract fewer new subscribers away from other suppliers than would be the case without these factors. However, in our view, these barriers were likely to be less relevant with regard to switching from traditional pay TV to OTT pay TV, including by downgrading to a more limited traditional pay-TV package (see paragraphs 5.45 and 5.46).

5.131 A low rate of actual switching between firms may be consistent with an alternative model of competition where consumers use the threat of cancelling their subscription to negotiate a better deal from their existing supplier. However, we did not believe that this sort of process, in itself, was likely to lead to effective competition in the pay-TV retail market, as the results of our December 2010 survey suggested that only about 30 per cent of pay-TV subscribers had considered switching in the last two to three years (see paragraph 5.37). Furthermore, Ofcom data suggested that very few consumers had attempted to negotiate with their pay-TV supplier and some of those who had were unsuccessful.[101] At the time of our report, we did not know whether this might change, and if so by how much, as a result of competition from OTT pay-TV retailers, though we noted that [✂] (see Appendix 4.2).

Ease of entry/expansion and countervailing buyer power

5.132 Where large-scale entry or expansion is easy, existing suppliers may be constrained by the threat of entry or expansion. However, it appeared to us that large-scale entry/expansion into traditional pay TV was not easy (see paragraphs 5.58 to 5.69), among other things because large-scale entrants needed to incur significant upfront costs in attracting subscribers and take account of the likelihood of a competitive response by existing suppliers. The same barriers also limited the scope for large-scale expansion by existing small suppliers of traditional pay TV. We noted that the largest telephony

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[98] Not all customers are able to have a satellite dish installed and some have aesthetic objections to installing a satellite dish on their dwelling. See also paragraphs 5.21 & 5.22.
[99] See paragraph 6.95*(a)* of our August 2011 provisional findings.
[100] We recognized that movies were an important part of the content offered on the OTT services of LOVEFiLM and Netflix, and therefore we considered the impact of these services on the significance of Sky Movies within the pay-TV market (see Section 6).
[101] Based on Ofcom's consumer decision-making surveys for July–August 2008, 2009 & 2010, we estimated that about 6 per cent of respondents had in the past two years asked their current supplier to match a better deal which they had seen with a different service supplier, and only just over half of these respondents were successful in getting the better deal matched (these figures excluded about 2 per cent of respondents to the survey who answered 'Don't know' to the relevant question).

and broadband suppliers (BT and TalkTalk) had entered traditional pay TV but had achieved only a relatively small scale compared with Sky and Virgin Media and, so far, they had not been able to expand rapidly to challenge these large incumbents. (We discuss the entry by LOVEFiLM and Netflix as OTT pay-TV retailers in more detail below.)

5.133 We noted that the ability to access content was among the factors relevant to entry and expansion (see paragraph 5.63) and, in the context of movies, we assess the significance of FSPTW content to subscribers' choice of pay-TV retailer in Section 6 and the barriers to gaining FSPTW content in Section 7.

5.134 The great majority of pay TV is purchased by final consumers and we did not consider that they held countervailing buyer power.[102]

Measures of the outcome of competition

5.135 If competition is ineffective, we would expect this to be manifested in worse outcomes for consumers. Examples of worse outcomes would be higher prices, lower quality and less innovation and choice than if the market were more competitive, though not all of these outcomes would necessarily be observed.

5.136 A difficulty with assessing outcomes is that we do not observe the competitive outcome so, without that benchmark, it is hard to judge whether outcomes are (relatively) good or bad compared with an effectively competitive counterfactual. For example, we may observe changes over time in real prices but, unless we know how the effectiveness of competition has changed over time, this does not really tell us anything about how observed prices compare with competitive prices.[103] Notwithstanding this difficulty, we considered indicators of market outcomes in the pay-TV market.

Profitability

5.137 One way of addressing the difficulty with evaluating outcomes is to look at measures of economic profitability, which assesses the difference between actual prices and economic costs.[104] If costs actually incurred are similar to competitive costs, high profits may be indicative of actual prices being in excess of competitive prices. Measuring economic profitability has its own difficulties but a situation where, persistently, profits are in excess of the cost of capital for firms that represent a substantial part of the market could be an indication of limitations in the competitive process.

5.138 We looked in detail at Sky's profitability and it appeared to us that Sky had persistently earned profits substantially in excess of its cost of capital (see paragraphs 5.92

[102] A small proportion of pay TV is purchased by businesses, for example pubs, but they too are small relative to the suppliers and are unlikely to hold countervailing buyer power.
[103] Our current guidelines *(CC3)* list the following indicators: prices, profitability, international price comparisons and other indicators. Profitability, international price comparisons and other indicators are dealt with below. As regards prices, the guidelines state (paragraphs 3.79 & 3.80) that prices in competitive conditions, though tending to the same level, are, over time, likely to exhibit significant variation as they respond to changing supply and demand conditions; this is less likely to be the case with oligopoly pricing, because the incentive not to depart from an established level of high prices may to some extent dampen the responsiveness of prices to costs and demand changes; of particular interest will be evidence of how prices adjust to changes in cost and demand conditions, and any evidence of competition in net prices (after discounts etc) notwithstanding that list prices may move in parallel. With regard to Sky Movies, we noted a modest price response to a large cost change (see paragraph 5.91) and that discounts up to now have been limited (see Appendix 5.1). However, in the circumstances of the pay-TV market, we did not attach much weight to these factors. While our new draft guidelines on market investigations do not replicate the current text in *CC3*, the approach set out in these draft guidelines would not suggest a different approach or outcome in the context of this investigation.
[104] Economic profitability is usually measured by comparing actual rate of return on capital with the cost of capital.

to 5.116 and Appendix 5.4). We did not see evidence that other companies had earned profits in excess of their cost of capital, but we noted that Sky itself accounted for a substantial part of the pay-TV retail market. In our view, Sky's high profitability was consistent with other evidence showing a lack of effective competition.

Innovation

5.139 Dynamic outcomes, in particular innovation, can be as important as, or more important than, static outcomes. However, innovation is difficult to measure and there is the same difficulty in assessing it as with static measures, in that we do not know the competitive level of innovation. Sky suggested that the UK was among the European leaders in innovation, but we could not infer very much from this unless competition was effective in other European countries.

5.140 As noted above, Ofcom recognized Sky's role as an innovator and said that the UK had a strong record on innovations in pay TV, in particular for those innovations, such as HD, which favoured satellite technology (see paragraph 5.78). However, Ofcom also said that there was evidence that Sky had avoided innovations which could cannibalize revenues from its own satellite platform.[105] In this context, we noted that the pricing structure Sky adopted for Sky Player (now Sky Go) could have been influenced by a desire not to encourage new subscribers to Internet-based viewing, as this might have cannibalized Sky's revenue from its satellite-based services (see paragraph 5.80). Thus, while we found that Sky had played a central role in developing innovative services, we believed that historically it had done so in a way that supported its own business model and, to that extent, it would have enhanced its strong position in the pay-TV retail market. The launch of Now TV by Sky, and the making available to consumers of Sky Movies on an unbundled basis distributed over the Internet, appeared to us to be a significant development but, in this regard, Sky appeared to be more of a follower than a leader.

5.141 Overall, the evidence suggested that, historically, there had been a significant level of innovation in the UK in pay TV, especially where innovations had favoured satellite technology.

International comparisons

5.142 Our guidelines state:

> International price differences may be an important indicator in deciding to refer a case to the Commission. The scope to use them as a definite indicator of a lack of competition is likely to be much more limited. … However, where international trade is relatively easy, the Commission would regard persistently large price differentials as one indicator of less than fully effective competition.[106]

Our guidelines also refer to the difficulty of taking into account international differences in factors such as range, quality, tastes and costs of land, capital, employment etc.[107] Taking account of these difficulties, we did not consider it appropriate to undertake a comparison of international prices.

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[105] Pay TV Statement, paragraphs 8.240 & 8.242.
[106] *CC3*, paragraphs 3.86 & 3.87. This approach to international price comparisons is also reflected in our draft revised guidelines on market investigations (see paragraph 116).
[107] *CC3*, paragraph 3.87.

5.143 However, Sky submitted evidence to us on this issue, which we considered. In its comments on our working papers, Sky said that we had failed to appreciate a number of issues, of which one was the relative comparability of prices for pay-TV movie services available in the UK to those available in other European countries, and it referred to a number of reports prepared by PwC on this matter for Sky. However, we noted that PwC's reports emphasized that there were substantial difficulties inherent in comparing pay-TV sectors across countries and also difficulties in obtaining consistent data on the prices of pay TV and subscribers to pay TV, and that any such comparisons should be made and interpreted with great care.[108] PwC made a number of further observations:

(a) There was the potential for data to suggest outcomes for consumers which, upon close inspection, reflected a vast array of factors which differed between countries and which may affect the pattern of pay-TV provision and consumption.[109]

(b) A price comparison in the absence of knowledge about the products being offered was not meaningful, and package offerings varied significantly.

(c) Although ideally prices should be adjusted to take into account any differences in quality of service, in order to conduct a proper assessment of value for money, this was outside the scope of its study.

5.144 Having made all these qualifications, PwC nevertheless sought to make price comparisons in respect of four types of package. These were *(a)* a 'most inclusive' package; *(b)* an 'inclusive of important sports' package; *(c)* an 'inclusive of important movies' package; and *(d)* an 'inclusive of important sports and movies'.[110] PwC found that:

(a) two packages from the UK (those of Virgin Media and Setanta) were not readily comparable with others on this basis;

(b) the price of Sky's 'most inclusive' package was below the average for the European pay-TV retailers included in its comparison; and

(c) the prices of Sky's 'inclusive of important sports', 'inclusive of important movies' and 'inclusive of important sports and movies' packages were slightly above average for the European pay-TV retailers included in its comparison.

We noted this research but, for the reasons set out in paragraph 5.142 we ascribed very little weight to it.

5.145 Sky also referred to international comparisons of penetration. Sky said that high levels of penetration in the UK of both general pay-TV services and premium pay-TV services were a direct reflection of their attractiveness (in terms of quality and pricing) and the significant efforts of Sky in particular in driving pay-TV sales. Sky said that it was implausible that such high penetration levels in relation to both basic-only and premium pay-TV services could have been achieved if prices for those services were set at high levels. Sky supported its views with the following evidence:

[108] *The outcomes for consumers in relation to pay TV in Europe*, PwC, a report for Sky, February 2008. PwC issued a supplementary report in January 2009 but this did not appear to have additional information on the level of prices (though it did report on changes in pricing and packaging, noting that there had not been considerable numbers of changes and nor did there appear to be territories that had experienced significantly more changes than others).
[109] The factors mentioned included differences in wealth, size, preferences for TV, platform types and stage of sector development; and also effective retailer choice, whether platforms are open or closed, whether consumers pay for cable access rather than 'genuine' pay TV, the number of FTA, basic pay and premium channels and overall quality.
[110] The latter three packages were the lowest-priced packages that included important sports content, movies content and both sports and movies content respectively.

(a) Sky said that PwC's February 2008 report had found that the UK had one of the highest levels of penetration of pay-TV services in Europe, matched only by Sweden and Norway.

(b) Sky also said that analysis it had undertaken in the past showed that, in 2009, nearly 25 per cent of UK households subscribed to premium pay-TV services (ie pay-TV packages with 'premium' channels such as Sky Movies and Sky Sports), which was likely to be the highest rate of penetration in Europe.[111]

5.146 We noted Ofcom's comment in its second pay-TV consultation that, while it had identified some gaps in the range of measures used, it broadly agreed with Sky that pay-TV penetration in the UK was high compared with other European markets, although it was lower than in the USA.[112]

5.147 However, as with international price comparisons, we believed that there were limitations in using international comparisons of pay-TV penetration as a measure of competition. In particular, comparisons of pay-TV penetration may be affected by other differences between countries, for example in tastes. Moreover, it was not clear to us that the PwC report reached such a clear conclusion on relative penetration as suggested by Sky,[113] and we did not see that Sky's subsequent analysis added much to the PwC report.[114,115] For these reasons, we ascribed very little weight to all of the international comparisons of penetration.

5.148 Overall, given the contextual difficulties, we found that we could infer little from the international comparisons of pay-TV pricing and penetration. Furthermore, we judged that it was difficult to infer much about the effectiveness of competition in the UK from an international comparison of pricing or penetration in the absence of evidence as to the effectiveness of competition more generally in those other geographic markets.

Other indicators

5.149 Sky suggested that there was other evidence indicating strongly that competition between pay-TV retailers was effective. Sky said:

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[111] *Penetration of pay TV in other European countries*, a study submitted to Ofcom by Sky in November 2009.

[112] Ofcom pay TV second consultation, September 2008, paragraph 7.29. Ofcom's First Pay TV Consultation included (Annex 9) an international pay-TV study by Spectrum Value Partners, dated September 2007. This stated that penetration of cable pay TV was 67 per cent and penetration of satellite pay TV was 27 per cent. However, it did not cover any of the five countries for which the PwC comparison of penetration was inconclusive (see first footnote to next paragraph).

[113] The PwC report's simple comparison of pay-TV penetration, based on Screen Digest data, showed that ten countries had higher penetration than the UK and four had lower penetration. PwC noted that these figures included pay TV which simply provided cable access to FTA channels and 'mini-pay' packages, which included a significantly higher proportion of FTA channels than 'genuine' pay-TV packages. PwC then recalculated the figures for five countries where the Screen Digest figures showed higher penetration than the UK (Figure 3): in one of these (Norway), the adjusted penetration remained substantially higher than the UK; in two countries (France and Sweden), adjusted penetration was similar; and in two countries (Belgium and Germany), adjusted penetration was lower. As regards the five other countries, PwC noted that it was likely that similar adjustments should be made in four other countries and possibly for the other country (Table 4), but was unable to calculate an adjusted penetration for these countries. The PwC supplementary report issued in January 2009 did not appear to have additional information on penetration.

[114] Sky's November 2009 submission to Ofcom ('Penetration of premium pay TV in other European countries') compared premium pay-TV penetration in the UK with that in four other countries. Three of these countries (Germany, Italy and Spain) were among the countries PwC had already found to have lower pay-TV penetration than the UK and the other country was France, which PwC found to have similar pay-TV penetration to the UK. Sky's comparison of premium pay-TV penetration suggested that penetration was 22 per cent in France, slightly below its figure of 25 per cent for the UK (Table 1 of Sky's study). We noted, however, that Sky's November 2009 submission to Ofcom related specifically to premium pay TV whereas PwC's comparison related to all pay TV excluding packages that provided only cable access and mini-pay packages.

[115] Sky said that there were many reasons why the USA (which has substantially higher pay-TV penetration than the UK) was not a relevant comparator in terms of the penetration of premium pay-TV services, for example because premium pay-TV services had been available in the USA for a far longer period of time than in European countries.

(a) 'UK consumers today have an enormous choice of high quality audiovisual programming available to them, provided by a variety of suppliers'; and

(b) 'all the available evidence on this matter points to significant levels of consumer satisfaction with the pay TV services available to them in the UK'. Sky said that no evidence had been presented, either during Ofcom's inquiry or our investigation, to support a view that there was substantial dissatisfaction with the pay-TV services available to consumers in the UK.

5.150 We accepted that a large range of pay-TV products was available in the UK and, overall, there was a good level of consumer satisfaction. However, in our view these measures were weak indicators of the effectiveness of competition. A large range of products might be available from a single supplier at a high price, but this could not be said to represent a situation of effective competition. Similarly, consumers may be satisfied with a certain quality of service and value for money even when prices are high. Generally, consumers have no way of comparing the prices they actually pay with the prices they would pay if the market was effectively competitive. Therefore, we attached little weight to these measures.

5.151 In its response to our revised provisional findings, Sky said that we had given insufficient weight to indicators such as the record of innovation and consumer satisfaction. Sky also stated that we had been inconsistent in our treatment of different types of evidence, for example that we had rejected evidence on product variety and customer satisfaction, and also that on international comparisons, in effect on the basis that their evidential value was ambiguous; yet, in Sky's view, exactly the same could be said of the evidence on Sky's profitability and consumer switching on which we had put weight in reaching our findings. We did not accept Sky's view. For each piece of evidence we considered what it could tell us about the effectiveness of pay-TV retail competition and ascribed what we considered to be appropriate weight to it.

OTT competition

5.152 Through the course of our inquiry, there were significant developments in the market relating to the emergence of OTT SVOD pay-TV services. Although only recent, these developments were clearly relevant to our analysis, and we could not attribute no weight to them simply because we had less evidence relating to them than in respect of the (now changed) circumstances before they were launched. Therefore, we exercised our judgement and considered their likely implications in the light of the evidence available.

5.153 We discuss the extent to which the OTT services of LOVEFiLM and Netflix are substitutes either for Sky Movies or for a package of traditional pay TV in Section 4 and Appendix 4.2. It appeared to us that, to date, these services had had a limited direct impact on demand for traditional pay-TV packages but, over time, we expected this constraint to increase, at least for packages offering general entertainment and movies (see paragraph 5.121).

5.154 We recognized that existing OTT services could only exercise an increasing constraint on traditional pay TV if at least one of LOVEFiLM and Netflix continued to offer suitable content at prices which were attractive to significant numbers of subscribers. While we could not be certain about future events, we had to make a judgement on the basis of the evidence before us and, as discussed in more detail in Appendix 4.2, we had no reason to expect that either Netflix or LOVEFiLM would exit the market in the foreseeable future. We noted that both LOVEFiLM and Netflix had signed multi-year content deals and multiple accessibility agreements, and these parties' intent to remain in the market for the foreseeable future was further supported by their internal plans for the UK market, as well as more generally by their wider international ambitions and scale.[116] We also noted that the new OTT services had proved popular, attracting a significant number of subscribers in a short period of time. Overall, we expected at least one OTT supplier to remain in the market in the longer term.

5.155 We recognized the potential for a competitive response from the incumbent players (or, possibly, other new entrants) to impact on the future prospects of the LOVEFiLM and Netflix OTT services. In particular, we considered the potential impact of Sky's new OTT service (Now TV), taking into account as far as possible Sky's broader strategy and incentives.

5.156 In our view, Now TV will be a closer competitor to the OTT services of LOVEFiLM and Netflix than Sky's traditional pay-TV service, although we noted that it is differentiated from the OTT services of LOVEFiLM and Netflix by the extent of the FSPTW content offered (on Sky Movies) and, increasingly, in due course, by its sports offering and other entertainment content. We noted that Sky had stated publicly that Now TV was designed for a new audience of people who did not currently have paid-for TV,[117] [✂]. Sky's internal business documents [✂] suggested that [✂]. Sky's forecasts showed that it planned to gain between [✂].[118] It seemed to us that these projections [✂] compared with those of Netflix and LOVEFiLM, and in light of the success achieved to date by both those two parties.[119] In our view, one reason why Sky's projected subscriber numbers were [✂] compared with those of Netflix and LOVEFiLM was because [✂]. We noted that our February 2012 survey suggested that 69 per cent of Netflix and LOVEFiLM subscribers who were likely to continue their subscriptions were or had recently been traditional pay-TV subscribers (see Appendix 4.2).[120] In this context, we also noted that the price of Sky Movies on Now TV (£15 per month) was higher than that of the LOVEFiLM and Netflix services (£4.99 and £5.99 per month respectively).

5.157 It appeared to us that, overall, Sky's current plans [✂]. However, we recognized that there were many reasons why the numbers achieved by any of the OTT pay-TV retailers could differ from their forecasts. In relation to Sky, we noted that, [✂],[121] but the prices Sky could charge for its OTT services were likely to be affected by the prices it charged for its traditional pay-TV services in order to minimize cannibalization.[122] We also noted that, in competing with LOVEFiLM and Netflix for OTT subscribers, Sky did not have the incumbency advantage it had in traditional pay TV. On the basis of the evidence available to us, we had no reason to expect Sky to achieve in OTT pay-TV retailing the very large share of subscribers which it had achieved in traditional pay-TV retailing.

5.158 In its consultation document prior to making its reference to us, Ofcom noted that the importance of linear movie channels appeared to be gradually declining, as illustrated

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[116] Netflix currently operates in the USA, Canada and Latin America (see Appendix 4.2, paragraphs 60–75) and told us that it planned to launch in [✂]. LOVEFiLM currently operates in Germany and Scandinavia and told us [✂].

[117] [✂]

[118] [✂]

[119] See paragraphs 2.142 & 2.143 and Appendix 4.2. Netflix's [✂] forecast showed it reaching [✂] subscribers by June 2013 and [✂] subscribers by June 2014, [✂]. LOVEFiLM's projections showed it reaching [✂] paying subscribers by the end of 2013 (including subscribers to all LOVEFiLM products, though, by the end of 2013, it forecast to have nearly [✂] per cent of its content being viewed on a streamed basis rather than on DVD).

[120] We recognized that the results of our February 2012 survey in general had to be interpreted with caution but we did not consider that the issues identified would have impacted on this particular survey result.

[121] We recognized that Sky's prices were not directly comparable with those of LOVEFiLM and Netflix because its content was different (Sky Movies shows many more FSPTW movies and, where relevant, Sky's basic entertainment channels show some original programming whereas the OTT services of LOVEFiLM and Netflix show previously-broadcast TV programmes). The Sky Movies service on Now TV is the same as the dual movies offering on Sky's DTH platform, except for the fact it excludes the Disney Cinemagic and MGM HD channels. Sky told us that [✂]. We noted that [✂].

[122] [✂] (see paragraph 5.156).

by the limited demand for them from pay-TV retailers, and that subscription services offering recent movies on demand seemed to present a more compelling long-term proposition and a stronger proposition for securing effective competition. Ofcom said that the wider availability of these services would therefore provide an immediate benefit to consumers and also a potential longer-term benefit, in that the ability to provide high-value video content on demand was one of the commercial justifications for investing in new superfast broadband networks. Ofcom considered that movies were particularly important in this context, being both valuable to consumers and well-suited to a true VOD service, and that limited access to such content risked holding back such investment, with a wide range of resulting consequences for consumers. Ofcom said that:

> Given Sky's joint control of both premium SVoD and linear movie rights, we are concerned that it could be the only player to take advantage of these developments. As a result we are concerned that Sky will maintain its market power, and will exploit that market power by restricting exploitation of SVoD rights and restricting distribution of resulting services. We believe it is unlikely that, absent intervention, competition will develop or the market will deliver the full benefits of SVoD services.[123]

5.159 These concerns were expressed prior to the entry of Netflix and LOVEFiLM's OTT SVOD services and it appeared to us that Ofcom's concern that Sky's market power in pay TV would prevent the emergence of competition in SVOD services had not been realized. In our analysis above, and in our detailed assessment of the OTT services of Netflix and LOVEFiLM in Appendix 4.2, we considered carefully the likely future prospects of these services in order to evaluate the weight that should be placed on these developments in our overall analysis. In our judgement, given the rivalry that, by the time of this report, was already taking place, including through the launch of Now TV, and with reference to our expectation as to the likely sustainability of at least one of the OTT services of LOVEFiLM and Netflix in the market in the longer term (see paragraph 5.154), we judged that competition in relation to OTT SVOD services was likely to be sustained. Moreover, we expected OTT services over time to become closer substitutes for traditional pay TV and, consequently, increasingly to constrain traditional pay-TV retailers (see paragraph 5.121). Nevertheless, we could not exclude the possibility that circumstances could arise which could limit the development of OTT services in competition with Sky in the future and, in this regard and in the light of our judgement that Sky has market power in the pay-TV retail market, we believed that the conditions of competition should be kept under close review.

5.160 In its response to our working paper on the market developments since our provisional findings,[124] Ofcom said that it viewed the new SVOD services offered by LOVEFiLM and Netflix as positive market developments, and recognized that they had the potential to deliver better consumer outcomes in a market which was dominated by a very small number of players. Ofcom said, however, that it still believed that the key factor in the demand for any pay-TV service was the ability to access compelling content and that FSPTW movie content from the six major studios was particularly important to competition in the pay-TV sector. We discuss this issue in

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[123] Paragraphs 1.9 to 1.11 of *Competition issues in premium pay TV movies, proposed reference to the CC*, Ofcom consultation, 31 March 2010:
http://stakeholders.ofcom.org.uk/binaries/consultations/movies_reference/summary/moviescondoc.pdf.
[124] Ofcom's response to Working Paper 29:
www.competition-commission.org.uk/assets/competitioncommission/docs/2010/movies-on-pay-tv/ofcom_submission_to_cc_on_wp29_no_confidential.pdf.

detail in Section 6, in particular the significance to consumers of FSPTW content (and Sky Movies which has the majority of this content) in their choice of pay-TV retailer and the impact of the emergence of OTT services with movie content on this issue.

5.161 In addition to the new OTT SVOD services from LOVEFiLM, Netflix and Sky, there was also, over the course of our inquiry, an increase in the number of retailers providing TVOD services distributed over the Internet (see paragraphs 2.16 and 5.14). We noted that the availability of these services could affect subscription services (both those offered by traditional pay-TV retailers and OTT pay-TV retailers) as some consumers might regard transactional purchases as substitutes for some or all of their subscription service. However, we did not see evidence that this had yet happened at any scale.

5.162 In its comments on our revised provisional findings, Sky suggested that our analysis of retail competition was almost entirely backward looking and that this was particularly incongruous in view of the central role that developments related to OTT services had played in causing us to revise our view on the contestability of FSPTW movie rights. We did not accept that our analysis of retail competition was inconsistent with our approach in other areas. In our analysis of retail competition we took into account the recent developments which occurred through the course of our inquiry, including the launch of the OTT services of LOVEFiLM, Netflix and Now TV, just as in the rest of our report.

Conclusion of our assessment on pay-TV retail competition

5.163 In our view, competition between pay-TV retailers for subscribers is affected by barriers to switching, particularly with respect to switching entirely between traditional pay-TV retailers. These barriers are associated with the perceived inconvenience of changing retailer and with subscriber inertia. In addition, we found that there were significant barriers to large-scale entry and expansion for a traditional pay-TV retailer offering packages of pay TV, including substantial sunk costs both in setting up a new platform and in marketing to acquire subscribers (associated with the need to overcome the barriers to switching, in particular subscriber inertia) and the threat of a competitive response from existing players. Together with Sky's large number of existing subscribers deriving from its historical position (Sky's incumbency advantage) and the restricted geographical coverage of Sky's main historical competitor (Virgin Media), it appeared to us that these factors resulted in Sky having market power in the pay-TV retail market. The emergence of the OTT services of LOVEFiLM and Netflix, which offered movies and previously-broadcast TV programming on demand, had increased the extent of competition in the pay-TV retail market but not sufficiently to affect our conclusion that Sky had market power.

5.164 Overall, we found that there was some competition in the pay-TV retail market but the very high and stable level of concentration, the low level of switching between suppliers, the difficulty of large-scale entry/expansion as a traditional pay-TV retailer and the absence of countervailing buyer power in pay TV indicated that, at the time of our report, competition was not effective. We noted that Sky's high profitability from its pay-TV activities was consistent with this finding.

5.165 Although there had been a significant level of innovation in the UK in pay TV, it appeared to us that it had been biased towards the developments most favourable to Sky's satellite platform (eg HD) and, in our view, the evidence on innovation, even recent innovation in OTT services, was insufficient to change our view that competition in the pay-TV retail market was ineffective.

5.166 We found that Ofcom's concern that Sky's market power in pay TV might prevent the emergence of competition in SVOD services did not appear to have been realized as new SVOD services offering a broad range of movie (and other) content had entered the market and captured a sizeable subscriber base in a short period of time. Based on the evidence available to us at the time of reaching our findings, we expected competition in relation to SVOD services to be sustained and, consequently, we expected OTT services increasingly to constrain traditional pay-TV retailers over time. Nevertheless, we could not exclude the possibility that circumstances could arise which could limit the development of OTT services in competition with Sky in the future and, in this regard and in the light of our judgement that Sky had market power, we considered that the conditions of competition should be kept under close review.

5.167 Notwithstanding our finding that competition in the pay-TV retail market was not effective, the reference made to us required us to consider in particular the extent to which there were features associated with the distribution of Sky Movies and the acquisition of FSPTW rights from the major studios which adversely affected competition. A conclusion that competition was not effective in this market did not of itself lead to the conclusion that there was an AEC with respect to the matters referred to us. Nevertheless, this finding provided the context for the other parts of our analysis.

6. Significance of FSPTW movies to competition in the pay-TV retail market

Introduction

6.1 In Section 5, we set out our finding that competition in pay-TV retailing was currently not effective. We found that factors contributing to ineffective competition in pay-TV retailing included barriers to switching, such as customer inertia, barriers to entry and expansion, Sky's incumbency advantage and the restricted geographical coverage of Virgin Media, historically Sky's main competitor (see paragraph 5.163).

6.2 Traditional pay-TV retailers compete by, among other things, offering a wide range of content at different price points (see paragraph 5.50). Accordingly, we recognized that it was possible that an inability on the part of some providers to access content which is valued by subscribers could contribute to ineffective competition in pay-TV retailing. The particular focus of our inquiry was access to FSPTW movie content but in order for any limitations in the effectiveness of retail pay-TV competition to be attributable to movie products with FSPTW content, such movie products must be significant to consumers in their choice of pay-TV retailer. In this section, we therefore discuss whether pay-TV movie content in the FSPTW is significant to consumers in choosing their traditional pay-TV retailer and hence to competition in pay-TV retailing.[1] This was the second area of analysis in our theory of harm (see paragraph 3.9*(b)*).[2]

6.3 Given the centrality of this issue to our assessment of our theory of harm, as well as to our overall finding, and in light of the extensive evidence we received throughout our investigation on this issue (including in response to our August 2011 provisional findings and revised provisional findings), this section was restructured following our revised provisional findings to set out our reasoning in as clear and systematic a way as possible. However, the essence of our reasoning remains as set out in our revised provisional findings.

Overview

6.4 After providing an initial overview of the views of some of the parties on the issue of significance, the analysis in this section proceeds as follows.

6.5 We begin by presenting evidence on the extent to which pay-TV movie services in general are significant to pay-TV subscribers. We found that over recent years the proportion of movies viewed on pay-TV channels (including Sky Movies) had fallen, and survey responses indicated that only a small minority of consumers (7 to 9 per cent) first took out a pay-TV subscription specifically in order to get a better movies package.

6.6 We then set out evidence on the significance of Sky Movies to a consumer's choice of traditional pay-TV retailer. This evidence suggested that Sky Movies was significant to only around 10 per cent of traditional pay-TV subscribers.

6.7 Next we discuss the evidence relating specifically to FSPTW content, as the issue with which we were ultimately concerned in this area of our analysis was the signifi-

[1] Our concern was with the significance of *Sky's* FSPTW movie content to consumers' choice of *traditional* pay-TV retailer because Sky had the majority of FSPTW content and the ineffectiveness of competition in the pay-TV retail market derived from Sky's position in traditional pay-TV retailing.
[2] Paragraph 3.9*(b)* states 'pay-TV movie content in the FSPTW is significant to consumers in choosing their pay-TV retailer, which requires, among other things, that movie content on pay TV in the FSPTW has no close substitutes' . The absence of close substitutes would not, by itself, mean that FSPTW content was significant in this way.

cance of this content to pay-TV subscription decisions. We found that FSPTW content was important to Sky Movies as a particular product or brand, but it did not necessarily follow from this that FSPTW content was significant to consumers' pay-TV subscription decisions across the market as a whole. In fact, the evidence suggested that the recency of movie content was important to far fewer Sky Movies subscribers than other attributes, in particular the range of movies on offer. More generally, the evidence suggested that a number of other attributes of movie services on pay TV were important to more consumers than the recency of the movies offered, namely the overall cost of the service, whether it was available on a subscription basis, the minimum contract period, the availability of movies on demand, the total number of movies, the number of movies added to the service each week and movies being available in HD.

6.8 We then present the evidence on the cost of acquiring FSPTW movies, and on recent trends relating to movie services and FSPTW content in terms of the level of viewing of Sky Movies and other channels and the proportion of Sky subscribers who subscribe to Sky Movies. We found that it was difficult to draw direct conclusions from the evidence on the costs of acquiring FSPTW movie rights in terms of the significance of FSPTW content. However, the evidence suggested that more recent movies were more valuable on a per-movie basis than older movies. This evidence also suggested that FSPTW content was valued by pay-TV retailers considerably less than premium sports content.

6.9 In summary, prior to considering the impact of the market developments which occurred during the course of our inquiry, the evidence which related to the market prior to late 2011 indicated that pay-TV movie services and Sky Movies were significant to the subscription decisions of only a relatively small minority of all pay-TV subscribers, and FSPTW content an even smaller minority.

6.10 We then discuss the implications of the recent entry of three new OTT services (LOVEFiLM, Netflix and Now TV) and, in particular, the extent to which this entry was likely to affect the subscription decisions of the small minority of all pay-TV subscribers for whom FSPTW content is significant in their choice of traditional pay-TV retailer.

6.11 The entry of these services was potentially relevant because, as a result, consumers could now choose to receive a movie service on an OTT basis while obtaining other pay-TV services from another provider. Thus, for example, a consumer could, rather than subscribing to a package from Sky including Sky Movies, instead choose BT or Virgin Media as their main pay-TV provider and also subscribe to the OTT service of LOVEFiLM or Netflix, or to Sky Movies on Now TV.

6.12 We considered the extent to which such alternative 'combination' packages were likely to be regarded as substitutable for Sky Movies by consumers for whom the availability of Sky Movies would otherwise have been significant to their choice of traditional pay-TV provider by reference to a range of evidence. We took into account, among other things, the relative importance to subscribers of different attributes of pay-TV movie services, the characteristics of the alternative services, survey responses from subscribers to the OTT services of LOVEFiLM and Netflix, and the potential drawbacks to subscribing to both traditional pay-TV and OTT pay-TV services. In our view, the three new OTT movie services were likely to be regarded as substitutes for Sky Movies on traditional pay TV for at least some of the group for whom Sky Movies would otherwise have been significant to their choice of traditional pay-TV provider.

6.13 Finally, we set out our assessment and conclusions on this area of our theory of harm.

Overview of some of the parties' views

6.14 This subsection summarizes briefly the overall views of some of the parties on the issue of significance. Their submissions and evidence on specific issues relevant to this issue are discussed in the various parts of our analysis as relevant, but here we present an overview. In summary, Sky's major competitors in the pay-TV retail market told us that FSPTW movie content was significant to a consumer's choice of traditional pay-TV retailer, and that being able to offer such content was necessary to compete effectively in that market; while Sky and the movie studios told us the opposite.

Sky's competitors in the pay-TV retail market

6.15 Virgin Media and BT are traditional pay-TV retailers which compete with Sky in the pay-TV retail market but, at the time of our report, each had a market share which was significantly smaller than that of Sky, in particular BT (see paragraphs 5.18 and 5.19). However, both these providers had a larger market share than Sky in the market for communications products (eg broadband and landlines), with which we observed pay-TV products to be increasingly bundled (eg at the start of 2012, BT's share of subscribers in broadband was 26 per cent, Virgin Media's share was 22 per cent and Sky's share was 17 per cent).[3]

6.16 In terms of paid-for movie services, at the time of our report, Virgin Media offered *(a)* Sky Movies, which it bought wholesale from Sky; *(b)* a TVOD movie service provided by FilmFlex; and *(c)* an SVOD movie service provided by PictureBox. BT did not offer Sky Movies, but it did offer an SVOD service, Vision Film, which comprised a combination of SSPTW and library movies, and a TVOD service.[4] Both Virgin Media and BT also offered Sky Sports.[5]

6.17 Virgin Media and BT both told us that being able to offer FSPTW movies would enhance their ability to compete with Sky in the pay-TV retail market, as follows:

(a) Virgin Media told us that premium movies were a key driver for consumers choosing pay TV over FTA TV and that the availability of Sky Movies drove pay-TV take-up and retention. Virgin Media said that it was essential for it to be able to offer a premium movies service on a commercially viable basis with content in the FSPTW, which, in practice, given Sky's exclusive access to the relevant rights, meant offering Sky Movies.[6]

(b) BT told us that, in order to compete with Sky, a pay-TV retailer needed to offer as broad a range of content as Sky at a comparable price, or a smaller offering but at a reduced price. BT suggested that being unable to access Sky's premium channels undermined a rival pay-TV retailer's potential to be an effective competitor to Sky as the rival could not provide an appealing TV proposition overall. BT said that, without access to movies from the major studios in the FSPTW,

[3] This is based on Ofcom's Nations and Regions Tracker for Q1 2012, 4 January to 27 February 2012, which also showed TalkTalk's share was13 per cent. BT told us that Sky's share was increasing.
[4] Vision Film is primarily offered bundled with other pay-TV content, for example it is part of BT Vision's 'unlimited' package. BT told us that Vision Film was available on a stand-alone basis [✂].
[5] Virgin Media offered all the Sky Sports channels. BT offered the Sky Sports 1 and 2 channels. In the recent auction for FAPL rights for 2013/14–2015/16, BT acquired the rights to show 38 games each season, thereby expanding its sports offering.
[6] In support of this view, Virgin Media [✂].

pay-TV retailers were less likely to invest and innovate in new services (or alternative pricing structures) which would enable them to attract and retain customers.[7] In particular, BT said that it had the technology to offer a full SVOD service but it had not developed this service as it did not have access to the necessary SVOD movie rights. BT said that its TVOD and SVOD services which offered movies outside the FSPTW (ie in the TVOD window and in the SSPTW/ library windows respectively) were not sufficient to attract and retain customers.

6.18 TUTV, another traditional pay-TV retailer and competitor to Sky, told us that being able to offer movie content was not sufficient to ensure effective competition. Range and the recency of movies, the retail price, the attractiveness of the platform, and the marketing support offered to the platform were all essential factors affecting the competitiveness of a pay-TV retailer. However, TUTV said that, if it had access to FSPTW movies, [✂].[8] TUTV said that the results of its own consumer research indicated that the availability of Sky Movies was a determinant in consumers' choice of pay-TV retailer.[9]

6.19 LOVEFiLM and Netflix, each of which provide an OTT SVOD service comprising movies and previously-broadcast TV programmes, both offer a mix of movie content, with some FSPTW content from non-major studios. LOVEFiLM did not express a view to us on the significance of FSPTW content to consumers in their choice of pay-TV retailer (including in terms of subscribing to LOVEFiLM); but Netflix told us that, while FSPTW movies were part of the overall mix of content on its service, it was not necessarily at a disadvantage by not having major studio FSPTW content, at least not at its current price point.

Sky and the major studios

6.20 Sky and the major studios told us that neither Sky Movies nor FSPTW movie content were significant to a consumer's choice of traditional pay-TV provider. They said that survey evidence showed that the decisions of only a small proportion of pay-TV subscribers were affected by the availability of Sky Movies, and that this proportion was too small to be significant. In addition, they argued that surveys measuring the significance of Sky Movies to consumers' subscription decisions did not provide reliable evidence as to the significance of FSPTW content as more than half of all content on Sky Movies was non-FSPTW.

The significance of a provider's movies offering

6.21 As background to our analysis, we set out some evidence concerning the role of movies offerings within the pay-TV retail market.

6.22 As discussed in Section 2, the growth of digital multi-channels has resulted in an increase in the total number of movies broadcast on TV, without any increase in audience size. As a result, the average audience of movies broadcast on TV has fallen. Consumers have increasingly been watching movies on digital multi-channels, at the expense of watching them on PSB channels or on Sky Movies. This is despite the fact that movies shown on these digital multi-channels (and other FTA channels) are generally older than the FSPTW movies shown on Sky Movies. As a result, between 2003 and 2010 the number of movie viewings by Sky Movies subscribers

[7] BT referred to the results of its consumer research to support its views. We describe BT's consumer research in Appendix 6.1, paragraphs 42–47, and in paragraph 6.70 below.
[8] [✂]
[9] [✂]

declined by more than 30 per cent, from over 800 million to just over 550 million.[10] At the time of our report, Sky Movies accounted for only around 2 per cent of viewing hours by homes with pay TV and just over 1 per cent of viewing hours by all homes.[11]

6.23 Our December 2010 survey asked respondents what had made them first subscribe to a pay-TV service:

(a) 60 per cent unprompted gave as one of their reasons that they wanted a greater choice of TV; and this increased to 69 per cent after respondents were prompted with a list of reasons.[12]

(b) 7 per cent unprompted gave as one of their reasons the wish to watch more movies; and this increased to 22 per cent after prompting. These percentages were slightly higher among Sky's subscribers, with 9 per cent regarding more movies as a reason to subscribe to traditional pay-TV services, compared with 5 per cent for Virgin Media subscribers and 7 per cent for subscribers to other pay-TV services.[13]

(c) A higher proportion of respondents said that they first decided to get a pay-TV service to watch more sports—the percentages were 21 per cent unprompted, and 33 per cent including prompted responses.

(d) A similar but slightly lower proportion of respondents said that they first decided to get a TV service to watch more children's channels—the percentages were 6 per cent unprompted, and 19 per cent including prompted responses.

(e) A higher proportion of respondents said that they first decided to get a pay-TV service because they wanted a bundled service with broadband/telephone services—the percentages were 12 per cent unprompted, and 29 per cent including prompted responses.[14]

6.24 On the basis of this evidence, it appeared to us that consumer viewing habits had changed over recent years, and the number and proportion of movies viewed on pay-TV channels (including Sky Movies) had fallen. Survey responses indicated that only a small minority of consumers (7 to 9 per cent) first took out a pay-TV subscription specifically in order to get a better movies package, and also that a number of other factors were more important to consumers when making these decisions.

The significance of Sky Movies

6.25 We then considered the significance of Sky Movies to a consumer's choice of traditional pay-TV retailer, ie the extent to which a consumer's choice of traditional pay-TV retailer was affected by whether or not that retailer offered Sky Movies.[15]

6.26 The question relevant to our theory of harm was the extent to which traditional pay-TV retailers could not compete effectively for consumers without being able to offer the FSPTW movie content currently shown on Sky Movies (see paragraph 3.6) and,

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[10] See Table 2.5. The figures include the Sky Movies channels and also Disney Cinemagic (which is included in the dual movies packs offered by Sky and Virgin Media).
[11] See Figure 6.1.
[12] See Appendix 4.10, paragraph 40 & Figure 13. Some respondents gave more than one reason.
[13] Other pay-TV services comprised the following: BT Vision, TalkTalk, TUTV and others.
[14] The full results are shown in Appendix 4.10, Figure 13.
[15] Both the choice of retailer when first subscribing to pay TV and the choice of whether or not to stay with a retailer were relevant.

given that this would not be the case if the overall Sky Movies offering was not significant to consumer subscription decisions, we looked at this question first. We then considered the extent to which the significance of Sky Movies to some consumers' pay-TV subscription decisions was a result of the FSPTW movie content on Sky Movies as opposed to its other features (addressed in the next subsection).

6.27 In assessing the significance of Sky Movies, we first considered the number of subscribers to Sky Movies. We then analysed evidence on the significance of Sky Movies, beginning with consumer research before going on to consider other types of evidence. Next we considered the extent to which Sky Movies might be significant to consumers as part of an overall pay-TV package, before addressing a number of other issues raised by the parties.

The number of subscribers to Sky Movies

6.28 At the time of our report, Sky Movies was retailed by both Sky and Virgin Media (and some small cable operators). Table 6.1 shows the number and proportion of subscribers who purchased Sky Movies on these two principal platforms.

TABLE 6.1 **Sky Movies and Sky Sports UK subscribers by pay-TV retailer, May 2012**

	*Movies**	*Movies only*	*Movies & sports†*	*Sports only*	*Total premium subscribers*	*Total subscribers*
Sky ('000)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
%	[✂]	[✂]	[✂]	[✂]	[✂]	
Virgin Media ('000)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
%	[✂]	[✂]	[✂]	[✂]	[✂]	

Source: Subscribers' data provided by the parties.

*Includes all possible package combinations that include at least one Sky Movies product.
†Includes all premium packages that include both movies and sports: single movies together with single or dual sports, dual movies together with single sports, and Top Tier packages (ie dual sports and dual movies).

6.29 In May 2012, [✂] per cent of Sky's pay-TV subscribers[16] subscribed to at least one Sky Movies pack.[17,18] Approximately [✂] per cent of Sky's pay-TV customers subscribed to Sky's movie packs without subscribing to Sky's sports products, while [✂] per cent subscribed to both movies and sports packs.

6.30 Sky's premium sports and movie channels were less popular among subscribers to Virgin Media. Among all Virgin Media pay-TV customers, only [✂] per cent subscribed to a Sky Movies product. This was made up of [✂] per cent of Virgin Media pay-TV customers who subscribed to a Sky Movies pack without subscribing to a Sky Sports pack, and [✂] per cent who subscribed to both movies and sports packs.[19]

[16] Representing [✂] per cent of its subscribers to premium channels.
[17] As explained in Section 4, we defined a pay-TV pack as a group of channels and/or VOD content. We defined a pack or group of pay-TV packs as a pay-TV product if it is sold for a price (hence the Sky Movies products are those products that include Sky Movies packs—some of these also include Sky Sports packs eg dual movies/dual sports). We defined a pay-TV package as all the subscription pay-TV products purchased by a subscriber from a specific retailer (hence the Sky Movies packages are all the packages taken by subscribers whose subscriptions include a Sky Movies product).
[18] Specifically, either: *(a)* Sky Movies 1, a pack of five movie channels; *(b)* Sky Movies 2, a pack of five movie channels, of which four are different to Sky Movies 1); or *(c)* dual movies, a pack of 12 channels, comprising the nine channels in the two previous packs together with the Sky Movies Premiere and Sky Movies Showcase channels and Disney Cinemagic.
[19] Consequently, a [✂] of Sky's customers than Virgin Media's customers subscribed to Sky Movies (see Table 6.1). For the UK as a whole, Sky's share of Sky Movies subscribers was about [✂] per cent and Virgin Media's share was about [✂] per cent. This partly reflected that Virgin Media does not operate across the whole of the UK but, even in the areas where Virgin Media does operate, its share was only about [✂] per cent (and Sky's share was about [✂] per cent).

6.31 Taking account of all traditional pay-TV consumers, including customers of BT Vision, TUTV and TalkTalk,[20] we estimated that about one-third of all traditional pay-TV consumers subscribed to Sky Movies, and that around [✂] of Sky Movies subscribers also subscribed to Sky Sports.

6.32 These figures related to all existing subscribers. Sky also provided us with evidence on the proportion of new Sky pay-TV subscribers who subscribed to Sky Movies. Sky told us that, in the nine months to the end of March 2012, [✂] per cent of new Sky pay-TV subscribers took a package which did not include Sky Movies, [✂] per cent in the 12 months to the end of June 2011, [✂] per cent in the 12 months to the end of June 2010 and [✂] per cent five years prior to that. In other words, whereas [✂] per cent of all Sky pay-TV subscribers subscribed to at least one Sky Movies pack, the equivalent figure for new subscribers was [✂], ie [✂] per cent. Sky added that [✂].

6.33 In our view, the fact that a consumer subscribed to Sky Movies did not necessarily imply that Sky Movies was significant to that consumer's choice of traditional pay-TV retailer. A consumer might make exactly the same choice of traditional pay-TV retailer even if that retailer did not offer Sky Movies, ie it might be perceived as an 'optional extra' rather than a 'must have'. We noted in particular the following:

(a) Many consumers continued to subscribe to Sky Movies because they wanted Sky Sports and Sky Movies did not cost much extra. Ofcom's 2008 Willingness to Pay surveys suggested that about 44 per cent of Sky Movies/Sky Sports subscribers subscribed to Sky Movies for that reason.[21] Similarly, 2007 research by Ofcom suggested that, in response to a 10 per cent increase in the incremental price of the Sky Movies/Sky Sports element of their package, 18 per cent of respondents would drop the movies element of the package and only 4 per cent would drop the sports element.[22]

(b) Significant numbers of consumers continued to subscribe to Sky Movies simply because of inertia: our December 2010 survey showed that the most common reason for getting Sky Movies rather than another movie service was because the subscriber 'couldn't be bothered to change'.[23]

(c) We did not see evidence that a high proportion of Sky Movies customers were willing to pay substantially more for Sky Movies than its incremental price,[24] which might be expected if Sky Movies was significant to consumers' choice of traditional pay-TV retailer.[25]

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[20] BT Vision and TUTV do not offer Sky Movies. A [✂] number of subscribers on TalkTalk's platform subscribe to a version of Sky Movies provided as part of the Sky by Wire service.

[21] See Appendix 6.1, Table 1. 44 per cent of Sky Movies/Sky Sports subscribers is equivalent to [✂] per cent of all Sky Movies subscribers.

[22] See Appendix 4.4, paragraph 2. In this research, 7 per cent said they would switch to a basic TV package (ie drop sports and movies); 3 per cent would switch to FTA TV; and 1 per cent would switch to PPV movies.

[23] See Appendix 4.10, Figure 30. This answer was given by 23 per cent of respondents, with 10 per cent of respondents also saying that it was because they had telephone/broadband services with the same provider, and 10 per cent also saying it was 'part of the package'. The other most popular responses were better choice of films (22 per cent); don't know enough about other film services (13 per cent); cheaper (12 per cent); and more recent films available (9 per cent). The question asked was: 'Other TV providers offer film services via a monthly subscription package or on a pay per view basis. Why do you get Sky Movie channels rather than another film service?' Responses were unprompted and respondents may have given more than one response (though it would appear not many did so because the average number of reasons per respondent excluding don't knows was 1.2).

[24] Although we recognized that, given our finding that competition in pay-TV retailing overall was ineffective (see Section 5), it was possible that a notional competitive incremental price of Sky Movies could be lower than the existing incremental price of Sky Movies.

[25] The only quantitative evidence available on consumers' willingness to pay of which we were aware was from BT's survey (see Appendix 6.1, paragraph 45*(a)*). In this survey, Sky Movies subscribers were asked how much of a reduction in their total

(d) Only a relatively small minority of pay-TV subscribers appeared to choose their pay-TV retailer because of Sky Movies: our December 2010 survey suggested that the availability of Sky Movies potentially affected the choice of pay-TV retailer for about 10 per cent of all pay-TV subscribers (see paragraph 6.40).

6.34 For these reasons, it appeared to us that the number of subscribers to Sky Movies was likely to be substantially in excess of the number of subscribers for whom the availability of Sky Movies was significant in their pay-TV subscription decisions.

Evidence from consumer research

6.35 We considered consumer survey evidence on the significance of Sky Movies to consumers' pay-TV subscription decisions, noting that all of this evidence pre-dated the entry of LOVEFiLM and Netflix and the launch of Sky Movies on Now TV.

6.36 The first piece of consumer survey evidence we considered was the market research survey undertaken on our behalf by GfK NOP in December 2010 (see paragraphs 6.23 and 6.24 above). This survey sought to gather evidence on what drives pay-TV subscription decisions, how important movies are in the purchase decision, and how such decisions might be changed if new movie services were offered.[26]

6.37 The survey showed that 22 per cent[27] of subscribers to Sky Movies would stop paying for their current TV service if their provider[28] stopped offering Sky Movies.[29] This broke down into 12 per cent saying that they would switch to another pay-TV provider with Sky Movies, 3 per cent saying that they would switch to another pay-TV provider without Sky Movies and 4 per cent saying that they would cease to subscribe to pay TV altogether.[30] Given that Sky Movies subscribers represented about one-third of all traditional pay-TV subscribers (see paragraph 6.31), this evidence implied that about 7 per cent of all traditional pay-TV subscribers would stop paying for their current TV service if their provider stopped offering Sky Movies.

6.38 At the time of our report, Sky and Virgin Media (and some small cable operators) were the only traditional pay-TV retailers offering Sky Movies, and some Sky subscribers were not able to access cable and vice versa.[31] Therefore, we recognized that there could be further subscribers for whom the presence or absence of Sky Movies on a pay-TV platform would be important enough to induce a switch if they had been able to switch to a different pay-TV platform which also offered Sky Movies.[32] In principle, the fact that some survey respondents might not have had

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monthly subscription they would need to receive in order to be prepared to accept the loss of Sky Movies. [✂] BT advised us that this analysis of the results of its survey could be unreliable as it went against the logic of the methodology devised by the market research agency which undertook this work for BT. Furthermore, we attached relatively little weight to the results of the BT survey generally for the reasons set out in Appendix 6.1, paragraph 45.

[26] GfK NOP's report is in Appendix 4.10. The research was carried out on a face-to-face basis in December 2010. We recognized that advertising of Sky Movies was relatively high in December each year but we did not believe this would have had a material effect on the results given the general nature of the questions asked.

[27] 25 per cent ignoring those answering 'don't know'.

[28] The survey script and report (see Appendix 4.10) used the term 'provider' rather than 'retailer' and we use this term when referring directly to the survey results.

[29] 65 per cent said that they would stay with their existing provider and 13 per cent did not know whether or not they would continue to use their existing provider. See Appendix 4.10, paragraphs 55–56 and Figure 28.

[30] Additionally, 2.5 per cent of Sky Movies subscribers said that they would stop paying for their current TV service if their provider stopped offering Sky Movie channels but were not sure what they would do instead.

[31] Some Sky Movies content was also retailed by Sky on TalkTalk's pay-TV platform. We noted that Sky subscribers may not be able to access Virgin Media because Virgin Media's cables pass around only half of dwellings and that Virgin Media subscribers may not be able to access Sky if they are unable to place a satellite dish facing the right way on their dwelling and some may also be unwilling to have a satellite dish because of the impact on the appearance of their dwelling.

[32] This would be the case, for instance, if a Sky subscriber with Sky Movies in an area where Virgin Media is not available would switch to Virgin Media with Sky Movies if Sky stopped offering Sky Movies but, in the absence of the availability of Virgin Media (or any other provider offering Sky Movies), would remain with Sky. This is plausible if the subscriber values both Sky

such an option could have led the survey results to understate the percentage of subscribers for whom Sky Movies mattered to their choice of traditional pay-TV retailer.

6.39 In the period between our August 2011 provisional findings and this report, we reconsidered this issue in the light of submissions from the parties and further analysis. In its response to our revised provisional findings, BT said that the key cohort of consumers that our survey data had not captured was those subscribers who would have switched to another provider of Sky Movies if there had been an alternative provider. In BT's view, if a consumer's current pay-TV provider no longer offered Sky Movies, and another provider offering Sky Movies was not available, it was likely that the consumer would continue to subscribe to the same pay-TV provider, so long as they placed at least some positive value on the other elements of their pay-TV subscription. BT said that this was particularly likely in light of our findings on inertia and a lack of switching generally in pay-TV markets.[33] However, in our view, the survey results did not suggest that respondents who indicated that they would stop their current TV service if Sky Movies was unavailable were choosing just between Sky and Virgin Media. Only around half of such respondents said that they would switch to another pay-TV provider with Sky Movies (ie switch between Sky and Virgin Media). The other half said that they would either: *(a)* switch to another pay-TV provider without Sky Movies; or *(b)* cease subscribing to pay TV altogether (or they were not sure) (see paragraph 6.37). In our view, this had implications for the size of any understatement in survey responses which might arise due to the fact that some consumers did not have a choice between pay-TV providers with Sky Movies. We made an illustrative adjustment of the likely effect (see Appendix 6.3). This suggested that removing the understatement only increased the 7 per cent of pay-TV subscribers in paragraph 6.37 to between 8 and 11 per cent of pay-TV subscribers. This suggested that any understatement in the results of the survey indicating 'significance' was likely to be small.

6.40 Overall, it appeared to us that the responses to our December 2010 survey suggested that the availability of Sky Movies affected the choice of traditional pay-TV retailer for about 10 per cent of pay-TV subscribers.

6.41 We considered more generally the impact that inertia and the low rate of switching in pay-TV markets might have had on our survey results, and noted the following points:

(a) Even if our survey responses were influenced by switching barriers and customer inertia, they would still be informative of the extent to which the availability of Sky Movies on different platforms is capable of influencing consumer subscription decisions given the current realities of the market.

(b) However, it was unclear that inertia and low switching rates did have much effect on responses. In particular, the percentage of respondents saying that they would change their pay-TV provider if it stopped offering Sky Movies was similar for those who had switched their pay-TV provider in the past (who it is reasonable to assume were likely to be less affected by inertia and switching barriers) and for those who had not switched.[34] We also regarded responses as more indicative of what subscribers would do at a point in time when they were willing to switch than

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Movies (and hence prefers a retailer with Sky Movies to one without) and Sky's other pay-TV channels (and hence prefers continuing to subscribe to Sky to other alternatives).

[33] Our findings on inertia and a low rate of switching generally in pay-TV markets are set out in Section 5.

[34] See Table 115 of detailed survey tables, available on our website at: www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/inquiry/ref2010/movies_on_pay_tv/pdf/results_of_survey_data_tables.pdf.

of subscribers' instantaneous action in response to Sky Movies ceasing to be available.

(c) In light of this, it was possible that the survey responses might have materially over- rather than understated the actual proportion of subscribers who would switch if their current provider stopped offering Sky Movies. Pay-TV retailers told us that they were frequently successful in retaining existing subscribers who contacted them to say that they were considering stopping or downgrading their service (see Appendix 5.1), which meant that many of those who indicated that this would be their intention in response to our survey question might not have followed it through in reality.[35] In our view, it was likely that our survey responses effectively captured the switching intentions of subscribers before they informed their provider of their intention to switch, and therefore overstated the proportion of subscribers who would in fact end up switching. If, for example, the traditional pay-TV retailers offering Sky Movies succeeded in retaining half of the subscribers who said they would change their pay-TV provider if Sky Movies were no longer available, the proportion of subscribers affected by the availability of Sky Movies would be reduced by half to around 5 per cent.[36]

6.42 Our December 2010 survey also suggested that about 6 per cent of all traditional pay-TV subscribers regarded Sky Movies as very important in their decision to have a traditional pay-TV service, and 11 per cent considered it quite important.[37] We attributed less weight to responses to this question than to that on what respondents would do if their pay-TV provider no longer provided Sky Movies for two reasons: first, the concepts of 'very important' and 'quite important' were less precise; second, when asked this particular question respondents were not asked about other types of content to put the importance of Sky Movies into context. It was also not clear to us that Sky Movies could be said to be significant to the subscription decisions of those who responded that Sky Movies was only 'quite important'. Recognizing this need for some caution when interpreting the results, it nevertheless appeared to us that the range of consumers who said in response to this question that Sky Movies was of some degree of importance (ie from the 6 per cent who regarded Sky Movies as 'very important' to the 17 per cent who said that it was 'very' or 'quite' important) was broadly consistent with the figure of 10 per cent from the question asking respondents what they would do if their pay-TV provider no longer provided Sky Movies (see paragraph 6.40).

6.43 We also had regard to consumer research carried out by Ofcom and some of the traditional pay-TV retailers. The results of this research, which we summarize in Appendix 6.1, were consistent with the results of our own survey.

6.44 For example, Ofcom's *Pay TV research (phase 1)* asked pay-TV subscribers what specific channels were important to them. 12 per cent cited Sky 1, 9 per cent cited Sky Sports and the Discovery Channel, 5 per cent cited the Living Channel, and just 2 per cent cited Sky Movies. Sky Movies had a similar response rate to National Geographic, Nickelodeon Jr, Hallmark, Sci-Fi and the Cartoon Network. Spontan-

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[35] Sky said that it was able to retain [✂] per cent of such customers, while the equivalent figure for Virgin Media was [✂] per cent.

[36] This calculation was purely illustrative. We were also not suggesting that pay-TV providers would be as successful in retaining customers in the scenario of Sky Movies being no longer available as they were generally. The point was simply to illustrate that it was possible that responses to our survey may over- rather than understate the true percentage of consumers whose subscription decisions were affected by the availability of Sky Movies.

[37] This was implied by the fact that 17 per cent of subscribers to Sky Movies regarded it as very important in their decision to have a traditional pay-TV service, with 34 per cent regarding it as quite important, and one-third of all consumers of traditional pay-TV subscribed to Sky Movies. Further, 16 per cent said that it was neither important nor unimportant, 26 per cent said it was not very important and 7 per cent said it was not at all important. See Appendix 4.10, paragraph 54 & Figure 27.

eous channel mentions for the PSB channels tended to be higher, eg 18 per cent cited BBC1.

6.45 We also noted research by Sky which suggested that [✂] per cent of its subscribers continued to subscribe to Sky because of the presence on Sky's services of specific TV channels (or groups of channels) and that [✂] per cent of Sky's subscribers who said that they continued to subscribe to Sky because of specific TV channels (or groups of channels) mentioned the Sky Movies channels.[38] We noted that this was considerably lower than the percentages saying they continued to subscribe because of Sky Sports ([✂] per cent) and Sky 1 ([✂] per cent). We interpreted Sky's figures as suggesting that, over the 12 months to September 2010, [✂] per cent of all Sky subscribers continued to subscribe to Sky because of the availability of Sky Movies, and that this was lower than the percentages for Sky Sports ([✂] per cent) and Sky 1 ([✂] per cent).

Other evidence

6.46 If Sky Movies was significant to consumers in their choice of traditional pay-TV retailer, we would expect it to figure prominently in Sky's marketing. Sky told us that [✂]. From our own observations, we noted that there was some activity by Sky in marketing its movie channels, as well as its other products, in the summer, but the period when Sky's marketing focused primarily on Sky Movies was just prior to Christmas. Sky said that out of its total above-the-line advertising spend on promoting pay TV of £[✂] million in 2010/11,[39] £[✂] million ([✂] per cent) was movie-led advertising,[40] £[✂] million ([✂] per cent) was advertising that may have made occasional reference to Sky Movies but for which the focus was on other aspects of Sky's services and £[✂] million ([✂] per cent) was advertising that made no reference to Sky Movies.

6.47 Sky told us that the proposition that its premium movie channels were any longer a 'key driver' of new pay-TV subscriptions was wrong. Sky said that there had been a [✂] reduction in the percentage of new Sky subscribers taking Sky Movies, from [✂] per cent in 2005 to [✂] per cent in the nine months to March 2012, and [✂] (see paragraph 6.32). Sky said that [✂].

6.48 Sky said that its research of new customers confirmed the relative lack of importance of its movie channels as a driver of subscriptions compared with other factors. Sky said that, in the nine months to end March 2012, less than [✂] per cent of respondents to its survey of new customers cited Sky Movies as the main reason they had decided to purchase pay TV from Sky.

6.49 As to the significance of movies generally to competition between traditional pay-TV retailers, Sky said that movies were one of the things which pay-TV customers wanted to be offered on a service[41] but that, over time, they had dropped down the list in terms of importance. Sky said that, [✂]. When we asked why then Sky continued to sign contracts with all six major studios, Sky said that there was a [✂]. In our view, these comments by Sky were consistent with Sky's internal documents and data on recent viewing and subscription trends (see paragraphs 6.28 to 6.32). For example, an internal Sky document recorded that, in recent years, [✂]. Sky also told

[38] Figures relate to the 12 months from October 2009 to September 2010 (see Appendix 6.1, paragraph 32).
[39] Sky's total above-the-line marketing spend in 2010/11 was £[✂] million, of which £[✂] million related to the UK (rather than the Republic of Ireland) and £[✂] million related to broadband and telephony services (rather than pay TV).
[40] Sky said that, of this, £[✂] million was spent on the 'Christmas movies' campaign and £[✂] million on the 'Anytime+ movies' campaign (which related both to movies and to Anytime+ functionality).
[41] Sky told us that [✂].

us that [✂]. In our view, this evidence from Sky was consistent with the average value placed on Sky Movies by consumers of pay TV having declined over time.

Sky Movies as part of a pay-TV package

6.50 Virgin Media told us that it did not dispute that, for many subscribers, Sky Movies was not the most significant driver of pay-TV subscription decisions. However, it said that this did not mean that Sky Movies was not determinative in the choice of retailer. It said that the significance of Sky Movies had been understated because Sky Movies was bought by customers as part of a bundle.[42] Virgin Media submitted that this was particularly relevant where consumer valuations for content within the bundle were synergistic. Virgin Media said that, where consumers had a preference for variety, adding content which increased variety within a bundle would necessarily increase the value of the bundle as a whole and, as a result, the stand-alone value of a single component was likely to differ from the incremental value of that component to the package. Virgin Media said that, for this reason, any consumer survey which concentrated on the stand-alone importance of Sky Movies would understate the actual importance of Sky Movies when bought with other content if Sky Movies served to increase the variety of content within the bundle and consumers had a preference for such variety. Virgin Media submitted that, if we were to rely on the results of surveys which focused primarily on the stand-alone value of Sky Movies, without interpreting the results in this light, we faced the risk of materially underestimating the importance that Sky Movies played in consumers' decisions.[43]

6.51 We agreed that it was important to consider Sky Movies within the context in which it was sold, which in almost all cases was as part of a package with other traditional pay-TV products,[44] and we did so throughout our analysis. For example, we included as Sky Movies subscribers both those who subscribed to a movies-only product and also those who subscribed to a combined movies and sports product. All the evidence upon which we relied focused on the actual choices which consumers faced (or might face) and used data based on the actual products offered by Sky. In relation to survey data, we did not carry out a hypothetical analysis of what consumers would do if hypothetically there were only a stand-alone Sky Movies product available. Rather, we looked at what consumers have done or would do in the situation where Sky Movies was no longer offered as part of a bundle with other pay-TV products. In particular, our analysis of what subscribers to Sky Movies would do if their current pay-TV provider ceased to offer Sky Movies captured the importance of Sky Movies within the context of the pay-TV package. If a consumer valued Sky Movies both on a stand-alone basis and because of the variety that it added to the overall package, then their response to Sky Movies becoming unavailable would capture both sources of value. The evidence suggested that, taking into account both its stand-alone and synergistic value, the availability of Sky Movies affected the choice of traditional pay-TV retailer for only about 10 per cent of pay-TV subscribers (see paragraph 6.40).

Other issues raised by the parties

6.52 We now address a number of other issues raised by the parties.

[42] At the time of our survey, Sky Movies was not generally available to consumers other than as part of a package or bundle (see paragraph 4.33).
[43] Virgin Media said that this was the case even in circumstances where consumers valued Sky Movies channels less than other elements of their bundles, but where they still valued movies highly enough that they would choose a bundle which contained Sky Movies over one that did not.
[44] Since July 2012 Sky Movies has also been available OTT on an unbundled basis through Now TV (see paragraph 6.129).

6.53 Virgin Media argued that the decision to purchase a larger package may be a household decision, rather than an individual one and, where this was the case, consumer research which asked only one member of the household (notwithstanding the fact that the member may be the 'decision maker') was likely to fail to reflect the importance of Sky Movies to other members of the household. However, we noted that this would only be the case if the survey respondent ignored the interests of other householders in responding to the survey questions, and it was not clear to us that this was the case. Further, even if it were the case, it would only bias responses if survey respondents tended to be those members of households uninterested in movies, and there was no reason why this should be so.

6.54 [✂], we noted that the evidence suggested consistently that Sky Sports was more significant to consumers in their pay-TV subscription decisions than Sky Movies (see paragraphs 6.23 and 6.24).[45] In particular, we noted that, at the time of our report, [✂]. It appeared to us that this evidence suggested that [✂] Sky Sports [✂] considerably more significant to pay-TV subscription decisions than Sky Movies. Overall, we did not agree with Virgin Media that [✂] Sky Movies was a significant determinant of a consumer's choice of pay-TV retailer.

6.55 Virgin Media also suggested that, in choosing a pay-TV provider, a consumer might be influenced by the fact that a provider offers Sky Movies even if the consumer does not choose to subscribe to it at that time, ie the consumer could attach an 'option value' to the possibility of subscribing to Sky Movies subsequently. While we accepted that this was theoretically possible, we did not see any evidence to suggest that such an effect existed or was likely to be material.[46]

6.56 BT said that market data understated the 'significance' of Sky Movies because Sky's refusal to wholesale Sky Movies to other traditional pay-TV retailers on terms which would enable them to compete effectively, together with the ineffectiveness of retail pay-TV competition generally, had reduced the number of Sky Movies subscribers from what it would otherwise be both on the platforms of other traditional pay-TV retailers and on Sky's platform.[47] However, we did not agree with BT's point because, in our view, any subscribers priced off Sky Movies by competition or pricing issues would be those for whom Sky Movies was not likely to be significant in their choice of traditional pay-TV retailer. In its response to our revised provisional findings, BT said that we had misunderstood its point which it said had related to the Sky Movies price being above the competitive level due to the lack of effective competition which we had identified, and hence our approach had failed to take account of existing market distortions. However, in our view, it would have been circular for us to assume that the Sky Movies price was above the competitive level, then to find on the basis of that assumption that Sky Movies was significant to pay-TV competition, and then to find on the basis of that finding that the Sky Movies price was above the competitive level. We understood BT's argument to be that consumers choose Sky rather than other pay-TV retailers because they want to include Sky Movies in their pay-TV

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[45] [✂]

[46] It was theoretically possible because many consumers upgraded their pay-TV package to include Sky Movies subsequent to first subscribing to a particular pay-TV retailer. However, this did not mean that such consumers anticipated upgrading to Sky Movies at the time they first subscribed, nor, even if they did, that they attached an option value to doing so.

[47] More specifically, BT said that the number of Sky Movies subscribers under-represented the number which would have existed were Sky to have wholesaled Sky Movies to other traditional pay-TV retailers on terms which would have enabled those other retailers to compete effectively. In particular, BT said that [✂]. BT said that, as a result, its pay-TV customers had been unable to subscribe to Sky Movies regardless of their appetite to do so. BT also noted that, in addition, the rate-card terms under which Sky wholesaled to Virgin Media were such that they limited Virgin Media's incentive and ability actively to market Sky Movies, thereby artificially reducing the number of Virgin Media subscribers who currently took Sky Movies. BT continued that the fact that retail competition was not effective also meant that the prices Sky charged its own customers for Sky Movies were likely to be above the competitive level, meaning it was likely that there were a lower number of Sky Movies subscribers on Sky's own platform than if competition had been effective.

package and other retailers either do not have Sky Movies or obtain it on unfair terms, which in turn has caused retail competition to be ineffective. However, in our view, it would necessarily follow under this argument that any consumers whose willingness to pay for Sky Movies was such that they did not subscribe to a Sky Movies package at all were not a source of competitive advantage for Sky compared with other pay-TV retailers. Moreover, although we found that pay-TV competition was not effective (see Section 5), with the possible effect that prices for pay-TV products generally were above the competitive level, this had no obvious implication for our analysis in this section. In particular, the ineffectiveness of pay-TV retail competition would not affect the percentage of pay-TV subscribers who would change their traditional pay-TV retailer if it no longer offered Sky Movies.

Summary: the significance of Sky Movies

6.57 In summary, on the basis of the evidence discussed so far, it appeared to us that Sky Movies was significant to the pay-TV subscription decisions of only a relatively small minority (about 10 per cent) of traditional pay-TV subscribers.[48]

The significance of FSPTW movies

6.58 Having considered the significance of Sky Movies, we now discuss in this subsection the evidence relating specifically to the significance of FSPTW content to pay-TV subscription decisions, as this is the issue with which we were ultimately concerned in this area of our analysis.

6.59 It was important for us to distinguish between two distinct issues, namely the extent to which FSPTW content may be: *(a)* important to the appeal of Sky Movies as a particular product or brand; and *(b)* significant to consumers when they are making pay-TV subscription decisions. We considered that these issues were distinct because it is possible that an attribute may be very important to marketing a particular product or brand, without being significant to consumer purchasing decisions across the market as a whole. This would be the case especially where the product in question is an optional addition that is not necessarily of interest to all consumers in the market.

6.60 In relation to the first of these issues, in our view it was clear that FSPTW movie content was important to the appeal of Sky Movies as a product or brand.[49] We noted, for example, that, in the year ended June 2011, [✂] per cent of Sky's expenditure on content for Sky Movies was spent on FSPTW content (see paragraph 2.77). Our full reasons for this view are set out in Appendix 6.2. Sky accepted this conclusion as being 'immediately obvious'.

6.61 Sky and the movie studios pointed out that it did not follow from this conclusion that FSPTW movies were all that mattered to consumers who valued Sky Movies, which gave rise to the second (and, for our purposes, more pertinent) issue identified above.

6.62 In relation to this issue, first of all we considered evidence from our December 2010 survey (see Appendix 4.10) and from surveys by Ofcom and BT, and then we con-

[48] The evidence also suggested that Sky Movies was less significant to consumers than some other pay-TV channels, including Sky Sports.
[49] We have used the term 'importance' rather than 'significance' here in order to distinguish the issue of the impact of FSPTW content for the appeal of Sky Movies from the ultimate issue of relevance to this area of our analysis, which is whether FSPTW movie content (and, in particular, the FSPTW movie content on Sky Movies) is 'significant' to consumers' pay-TV subscription decisions.

sidered some other evidence on consumers' preferences. Our analysis took into account, among other things, survey responses given by Sky Movies subscribers as to which attributes of movie services (in general) they most valued. These responses provided us with information about the proportion of Sky Movies subscribers who valued Sky Movies because of its FSPTW content, ie as opposed to its other attributes. If consumers for whom the availability of Sky Movies was significant to their pay-TV subscription decisions valued Sky Movies primarily for reasons other than its FSPTW content, then FSPTW content could not be said to be significant to consumers in their choice of traditional pay-TV retailer.[50]

Survey evidence

6.63 Our December 2010 survey asked respondents, including Sky Movies subscribers, what attributes they most valued of movie services in general.[51] Table 6.2 presents the results. Table 6.2 shows that 12 per cent of Sky Movies subscribers regarded the 'length of time you have to wait after a movie is shown at the cinema before you can watch it on TV' as a 'very important' attribute of a TV movie service. However, this attribute was very important to considerably fewer consumers than several other movie service attributes, including the overall cost of the service (which was the factor important to the most consumers), the availability of movies on demand, the availability of the service on a subscription basis and the minimum length of contract. In addition, the total number of movies available to watch (ie range) was considered to be very important by considerably more consumers than movie recency: 26 per cent of consumers thought that the range of movies was very important, more than double the proportion (12 per cent) who thought that movie recency was very important. Including those Sky Movies subscribers who considered different movie service attributes to be 'quite important' showed similar results, ie movie recency was considered to be very or quite important by fewer subscribers than several other movie service attributes.

[50] As these survey responses identified the extent to which subscribers to Sky Movies valued attributes of movie services in general (rather than specific attributes of Sky Movies), they were also relevant to our assessment of the extent to which Sky Movies subscribers were likely to regard other movie services (including those with less FSPTW content) as being substitutable for Sky Movies.
[51] Appendix 4.10 describes the CC survey, and detailed tables of the results are set out at:
www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/inquiry/ref2010/movies_on_pay_tv/pdf/results_of_survey_data_tables.pdf.
The question asked was 'I am now going to read out a number of different features, and for each one I'd like you to tell me how important it would be if you were choosing a TV film service'. Tables 184 and 187 at the link above set out the responses for current Sky Movies subscribers.

TABLE 6.2 **Importance of attributes of a TV movie service to Sky Movies subscribers**

percentage of Sky Movies respondents

	Very important	*Very or quite important*
The overall cost of the service	62	88
Films being available on demand—that is you can choose to watch them at a time you like	33	70
The service being available on a subscription basis—so you only pay a fixed monthly fee with no extras no matter how many films you watch*	27	67
The total number of films available to watch	26	70
The minimum length of contract	26	65
Films being available in high definition	19	47
The number of films added each week	16	59
The length of time you have to wait after a film is shown at the cinema before you can watch it on TV	12	52

Source: CC survey.

*A further response was 'films being available on a pay per view basis—so you pay a fixed amount for each film you watch, and do not pay for films you don't want to watch' (in effect films not being available on a subscription basis). 13 per cent of respondents said that this was very important and 41 per cent very or quite important.

6.64 Our December 2010 survey also asked Sky Movies subscribers why they subscribed to Sky Movies (these responses therefore related specifically to Sky Movies, rather than to movie services in general). The responses indicated that about 9 per cent of respondents with Sky Movies subscribed to it rather than another movie service because it had more recent movies available. However, other attributes of Sky Movies were again important to more consumers than movie recency: 22 per cent said that it was because Sky Movies had a better choice of movies (ie range). We also noted that 23 per cent said that they subscribed to Sky Movies because they could not be bothered to change (ie customer inertia).[52] However, these responses were somewhat difficult to interpret as they reflected a comparison with TVOD/PPV services (which offer more recent movies) as well as with alternative subscription services (which offer older movies), of which awareness may in any case have been limited.

6.65 Our survey also sought to measure the importance to consumers of various attributes of movie services by asking which combination of different attributes, from a series of options, respondents preferred.[53] The results of this part of the survey suggested that cinema release date was less important than how respondents paid for movies (ie by transaction rather than by subscription), price and the number of movies available on the service. However, we attached little weight to these results as they appeared inconsistent with the choices consumers actually made.[54] A further issue with the results of this conjoint exercise was that responses might not have captured an inherent advantage of a movie service with recent movies, ie that consumers would tend to find other movie services unattractive because they showed movies which many consumers would already have seen.

6.66 Nonetheless, overall, our December 2010 survey suggested that movie recency was only one of the attributes of a movie service valued by Sky Movies subscribers. Other attributes appeared to be important to a larger proportion of Sky Movies subscribers, in particular price and the overall range of movie content available.

[52] See Appendix 4.10, Figure 30. The question asked was: 'Other TV providers offer film services via a monthly subscription package or on a pay per view basis. Why do you get Sky Movie channels rather than another film service?'
[53] See Appendix 4.10, section 4.5.1, describing the results of the conjoint exercise.
[54] For example, only about 6 per cent of respondents said that they would pay £5 per month for a subscription package even though 25 per cent of respondents paid for Sky Movies, the great majority paying an incremental price of at least £7 per month (see Appendix 4.10, paragraph 89).

6.67 We found that these results were consistent with Ofcom and Sky survey data from 2007 to 2010 on consumers' reasons for subscribing to Sky Movies (summarized in Appendix 4.9). Ofcom research carried out in 2007 and 2008 suggested that the ability to watch recently-released movies was important to far fewer Sky Movies subscribers than having a wide range of movies. For example, in Ofcom's 2008 Willingness to Pay survey, 19 per cent of respondents said that they originally subscribed to Sky Movies to watch recently-released movies, compared with 39 per cent who said that it was to access a wider range of movies than on other TV (see Figure 1 in Appendix 4.9). [✂][55]

6.68 We also considered some BT research into the preferences of Sky Movies subscribers.[56] In this research, more respondents disagreed than agreed with the statement 'I would rather have a big library of older movies than a smaller selection of new movies' (24 per cent agreed but 36 per cent of respondents disagreed) but, on the other hand, respondents mostly agreed with the statement 'I tend to browse for a film I want to watch, it doesn't concern me whether it's a new movie or not' (66 per cent agreed but 9 per cent disagreed). Respondents were also asked to compare their Sky Movies service with a hypothetical library movie service showing a much wider range of older movies, and most respondents preferred their Sky Movies service (only about 17 per cent preferred the hypothetical library service, while 83 per cent preferred Sky Movies). However, we had some concerns about the validity of a comparison between an existing service, which is known to consumers, and an alternative purely hypothetical service. In addition, we attached relatively little weight to the results of this survey for the reasons given in Appendix 6.1, paragraph 45.

6.69 In its response to our revised provisional findings, BT said that we had reinterpreted various pieces of our own and Ofcom's historic market research in order to reach revised views on the issue of recency. BT said that this was inconsistent with our guidelines on market research, which stated that sound statistical research required the hypotheses to be tested or the measures to be estimated to be set down before any data was collected. However, we did not interpret or reinterpret any market research in a way that was inconsistent with the original purpose of that research. Further, in reappraising the conclusions we drew from the market research, we took into account the submissions we received in response to our August 2011 provisional findings, as was entirely appropriate.

Other evidence

6.70 We noted that data from the Official UK Charts Company, quoted in Ofcom's Pay TV Statement, suggested that a high proportion of DVD sales occurred soon after release date and that DVD prices declined rapidly after release date.[57] This suggested that many consumers of DVDs were willing to pay more for recency. We were also aware that TVOD prices were substantially higher for more recent movies (see Appendix 4.1). In our August 2011 provisional findings, we observed that, if con-

[55] In our August 2011 provisional findings, we noted that showing movies for the first time on TV was jointly (with having several opportunities to see desired movies) the aspect of Sky Movies with which subscribers were most satisfied. However, some respondents to our August 2011 provisional findings highlighted that satisfaction with an attribute was not the same as the significance of that attribute. We agreed with these views. It appeared to us that subscribers could be highly satisfied with an attribute of Sky Movies even if it was of little significance to their decisions about whether to subscribe or to continue subscribing to Sky Movies or to a particular pay-TV retailer.
[56] See Appendix 6.1, paragraphs 45–47.
[57] This is shown in Figures 89 and 90 of Ofcom's Pay TV Statement. Figure 89 states that up to 60 per cent of DVD revenue is in the first three months of DVD release and that up to 80 per cent of DVD revenue is before the FSPTW. The data also suggests that, by the start of the FSPTW, the typical DVD price has declined to about 55–60 per cent of the price in the first month after release, and that by the end of the FSPTW, the typical DVD price has further declined to about 35 per cent of the price in the first month after release.

sumers of these products had a strong preference for recency, it was likely that consumers of subscription movie products on pay TV would have the same preference.

6.71 However, a number of respondents to our August 2011 provisional findings pointed out that little could be inferred from a preference for recency, as consumers were likely to have many other preferences, for example for cheaper products, a wide range of movies, contract flexibility, etc. We agreed. We noted that, although recency may be one attribute of a pay-TV movie service on which Sky Movies would be rated higher than its rivals (as no other service offered the same extent of FSPTW content), other services may be rated higher on other attributes (see paragraph 6.66). In our view, consumers chose their pay-TV movie service on the basis of a number of preferences, all of which formed the basis of rivalry.

6.72 Respondents to our August 2011 provisional findings also pointed out that there were likely to be differences in the balance of consumers' preferences between when making a transactional purchase (eg for DVDs and TVOD) and when making a subscription purchase (eg for Sky Movies).

6.73 In the light of these responses, we did not believe that much could be inferred about the preferences of consumers of subscription pay-TV movie services, who pay for the right to view as many movies as they like from a range of movies over the subscription period, from the preferences of DVD and TVOD consumers, who pay for the right to view a specific movie or set of TV programmes. In particular, we recognized that, while consumers of pay-TV subscription movie products would tend to have a preference for recent movies over older movies, the survey evidence suggested that other attributes were important to more subscribers.

6.74 Disney told us that it [✂] that other attributes of Sky Movies were considered by more consumers to be important than movie recency, since consumers had many opportunities to view FSPTW movies shown on Sky before, during and after the FSPTW. Disney added that a movie became available on Sky Movies in the FSPTW only after [✂] copies of the title had been purchased during the initial months of the home entertainment window, and it remained available in the home entertainment window throughout the FSPTW.

6.75 In our August 2011 provisional findings, we also stated that, when we asked Sky whether it would wish to carry an alternative movies channel with FSPTW content if another company bid successfully for FSPTW rights, Sky indicated that it would carry such a channel. Sky told us that [✂].[58] In response to our August 2011 provisional findings, Sky that said we had attached undue weight to this statement. It said that it was plain that a pay-TV retailer which offered consumers a narrower range of movie content was at a disadvantage in attracting and retaining subscribers compared with one with a fuller range. Sky said that this was true with regard to all content, including sports channels, children's channels and military history channels. Sky said that this proposition was uninformative about the materiality of the competitive disadvantage. Sky told us that its statement simply reflected Sky's desire to cater to the broadest possible spectrum of consumer demands for pay-TV, which formed a key part of its brand as a pay-TV retailer. Sky said that it would not wish to provide Virgin Media (or any other competitor) with a source of competitive advantage derived from carriage of any TV channel which carried attractive content. Sky added that it wanted to carry all good-quality content that fitted with Sky's brand, whether movies or otherwise, because part of Sky's offering to customers had always been that Sky gave them everything.

[58] See paragraph 7.33 of our August 2011 provisional findings.

6.76 We considered Sky's response and we accepted that Sky's comments in connection with retailing alternative movie channels with FSPTW content may simply have reflected a desire to offer subscribers a wide variety of content, which would be consistent with its general retail proposition to consumers. Therefore, we recognized that these comments did not on their own imply that Sky believed that FSPTW content was significant to subscribers in their choice of traditional pay-TV retailer.

6.77 Virgin Media said that we had been wrong to state that Sky's comments in connection with retailing alternative movie channels with FSPTW content may simply have reflected a desire to offer subscribers a wide variety of content. In Virgin Media's view, the relevant question was whether Sky's control of FSPTW content provided it with a competitive advantage over its pay-TV retail competitors. Virgin Media said that, if Sky was able to compete simply by offering a 'wide variety of content', Sky could respond to a rival movie service with FSPTW content by offering more general entertainment programming, SSPTW content, etc, but Sky had specifically stated that it would wish to carry this channel to avoid giving a rival a 'competitive advantage'. In Virgin Media's view, this suggested that FSPTW content had specific appeal which could not easily be replicated with other content, which gave a retailer with exclusive control of this content a 'competitive advantage'. We considered Virgin Media's interpretation of Sky's comments and we recognized that these comments were capable of different interpretations. However, it seemed to us that, on their own, they did not imply that Sky believed that FSPTW content was significant to subscribers in their choice of traditional pay-TV retailer. We noted that Sky chose to carry many channels in order to provide its customers with a broad pay-TV service and it was unlikely that every one of these channels (or groups of channels) could be said to be significant in consumers' pay-TV subscription decisions.

6.78 In its response to our revised provisional findings, BT said that our view that recency was not an essential driver of pay-TV movie services was inconsistent with our statement in our revised provisional findings in relation to the rights market that it appeared to us from the marketing material and public statements of LOVEFiLM and Netflix that they used FSPTW content in particular to attract consumers to their services. BT submitted that this suggested that other content (either non-FSPTW content or TV programming) was not a good substitute for the small amount of FSPTW content on these services. However, in our view, while LOVEFiLM and Netflix might use the FSPTW content on their services in their marketing material in order to attract consumers, this had no clear implications for the significance of FSPTW content to consumers pay-TV subscription decisions. Any pay-TV retailer would be expected to advertise the attractive features of its service, but these features were likely also to include the price of the service, the range of the movies offered, etc, as well the availability of some recent movies. We observed that LOVEFiLM and Netflix used many of these other features in their marketing material.

6.79 We noted a number of comments by pay-TV providers which tended to support the view that, while movie recency was one important attribute of pay-TV movie services, it was not the only attribute valued by consumers and, in particular, consumers also valued the range and variety of movies on offer. In particular:

(a) BT told us that its consumer research found that, prior to the introduction of its Film Club offering (ie when it offered just the PictureBox service), the main reasons for dissatisfaction among its movie customers were [✂]. BT said that the introduction of Film Club (now branded Vision Film) had reduced the proportion of customers dissatisfied with its service by addressing these issues. However, BT added that there remained dissatisfaction with the fact that the [✂] was still the main cause of dissatisfaction with this service.

(b) Sky said that the decline in the importance of Sky Movies as a driver of pay-TV subscriptions was evidenced by [✂] and by making other improvements to the service, such as: *(a)* replacing its three old movie channels with nine new genre-based channels in April 2007; *(b)* introducing a new movies magazine for subscribers in 2008; *(c)* introducing the 'Showcase' channel in March 2010; *(d)* improving the scheduling of movies across its channels (and improving the means of 'navigation' between movies); and *(e)* gradually introducing HD channels from 2007. Sky added that other factors which had improved the appeal of Sky Movies to consumers were its investment in HDTV, and the launch of Sky Anytime (and, subsequently, Anytime+).

(c) TUTV told us that being able to offer movie content was not sufficient to ensure effective competition (see paragraph 6.18). TUTV said that range and the recency of movies, the retail price, the attractiveness of the platform, and the marketing support offered to the platform were all essential factors affecting the competitiveness of a traditional pay-TV retailer.

Summary of the significance of FSPTW movies

6.80 Overall, considering all the evidence, it appeared to us that whilst the recency of movie content was of value to some consumers as an attribute of a pay-TV movie service, other attributes were important to more consumers. In particular, price was the attribute of importance to the largest group of consumers, and both the range of content offered and the minimum contract length were important to a larger proportion of consumers than movie recency.

The cost of acquiring FSPTW movies

6.81 In this subsection, we discuss the cost of acquiring FSPTW movies compared with the cost of acquiring other pay-TV content.

6.82 In summary, we found that the cost of acquiring FSPTW movie content was considerably greater than the cost of acquiring older movie content, but was considerably less than the cost of acquiring certain premium sports content, and less than or equivalent to the cost of some TV programming.

6.83 Sky told us that the amount it spent on licensing FSPTW rights (about £[✂] million a year)[59] was [✂] the PSBs spent on movie rights (£239 million in 2010), [✂] it spent on sports rights (over £[✂]),[60] and [✂] it spent on content for Sky 1, 2 and 3 (around £[✂] million). Sky also said that it was [✂] the amount the BBC spent on content for BBC One (£1.1 billion in 2010/11), and was [✂] the amount the BBC spent on content for BBC Four (£545 million in 2010/11).

6.84 In our view, whilst it was true that the amount a supplier of a pay-TV movie product was willing to pay for FSPTW rights suggested that these rights were of some value to consumers, this was also true, albeit to a lesser extent, for SSPTW rights, TSPTW rights and indeed library rights for some movies. While we recognized that each movie was more valuable, other things being equal, in the FSPTW than in subsequent windows, this did not mean that a movie in the FSPTW could not be substi-

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59 [✂]

60 In June 2012, the FAPL auctioned the UK live TV rights to premiership games for 2013/14–2015/16. Sky paid £760 million per year for the rights to televise 116 games, ie almost [✂] as, at the time of our report, it paid to license all of its FSPTW rights. In order to license 38 games per season (around one-quarter of all games televised live), BT paid almost £250 million per year, ie [✂] the current cost of FSPTW movies from all six major studios.

tuted by, say, two movies in the SSPTW or indeed by other attributes of pay-TV movie products, some of which appeared to be more important than recency (see paragraphs 6.63 to 6.80). Consequently, we believed that the fact that suppliers of pay-TV movie products had been willing to pay more for FSPTW rights than for other movie rights did not necessarily provide us with useful information about the significance of FSPTW rights to consumers in their choice of their traditional pay-TV retailer.

6.85 BT told us that if a movie in the FSPTW could be substituted by a number of less recent movies, it would be expected that the vast library output from a given studio should command a similar value to that of the studio's FSPTW output. However, BT said that this was not the case, either in the UK or anywhere else. It said it understood that a studio's FSPTW movie output (with a limited number of recent movies) cost many multiples of the cost of its library output (with a vast range of older titles). [✂], our data showed that the total value of FSPTW output was [✂] than the total value of library output: Appendix 9.1, Table 1, shows that, in 2008 and 2009, for the UK [✂]; and on average for the other countries considered, [✂].[61] Subsequent to 2009, [✂]. This evidence suggested that, although a particular movie would be more valuable to a pay-TV service the earlier it was available, the total value of older movies was at least as great as the total value of movies in the 15-month FSPTW.

6.86 Virgin Media said that our view that a movie in the FSPTW could be substituted by movies in later windows was not consistent with our view that the FSPTW was temporally distinct, which implied that substitution between windows was sufficiently weak for the FSPTW to remain a separate price discrimination market (see Section 4). However, we did not see any inconsistency. For an individual movie, the FSPTW rights are more valuable than rights in later windows, and hence command a higher price but, given that many attributes of a movie service, including range as well as recency, are important to consumers, in our view a movie in the FSPTW could be substituted by, say, two movies in the SSPTW or indeed by other attributes of pay-TV movie products.

6.87 In summary, it appeared to us that the fact that the cost per movie of FSPTW rights exceeded the cost of older movie rights (such as SSPTW, TSPTW and library rights) supported the idea that recency was of some value to consumers, but it did not in itself imply that FSPTW movies were significant to consumers in their choice of traditional pay-TV provider. In our view, movies in the FSPTW could be substituted by more movies in later windows (given the importance of range to consumers) or by other attributes of pay-TV movie services. We also noted that the comparatively low value of FSPTW movie rights relative to other pay-TV rights suggested that other content (in particular FAPL sports content) might be more significant to consumers in their pay-TV subscription decisions, though we recognized that this did not in itself indicate that FSPTW movie content was not significant. Overall, we found that it was difficult to draw conclusions about the significance of FSPTW movies to consumers in their choice of traditional pay-TV retailer simply from the amount paid for FSPTW rights.

Recent trends

6.88 In this subsection, we discuss the extent to which the significance of Sky Movies or FSPTW movie content to consumers' pay-TV subscription decisions has changed

[61] We noted that a comparison of the cost of FSPTW rights and rights in subsequent windows was complicated by many factors, including the length of window and the specific form of exploitation which was being licensed. Nevertheless, it appeared to us that the evidence available did not support BT's point.

over the past few years. We present evidence on changes in the level of viewing of Sky Movies and other channels and the proportion of Sky subscribers who subscribe to Sky Movies. We also summarize relevant submissions from some of the parties on this issue (to the extent not covered elsewhere).

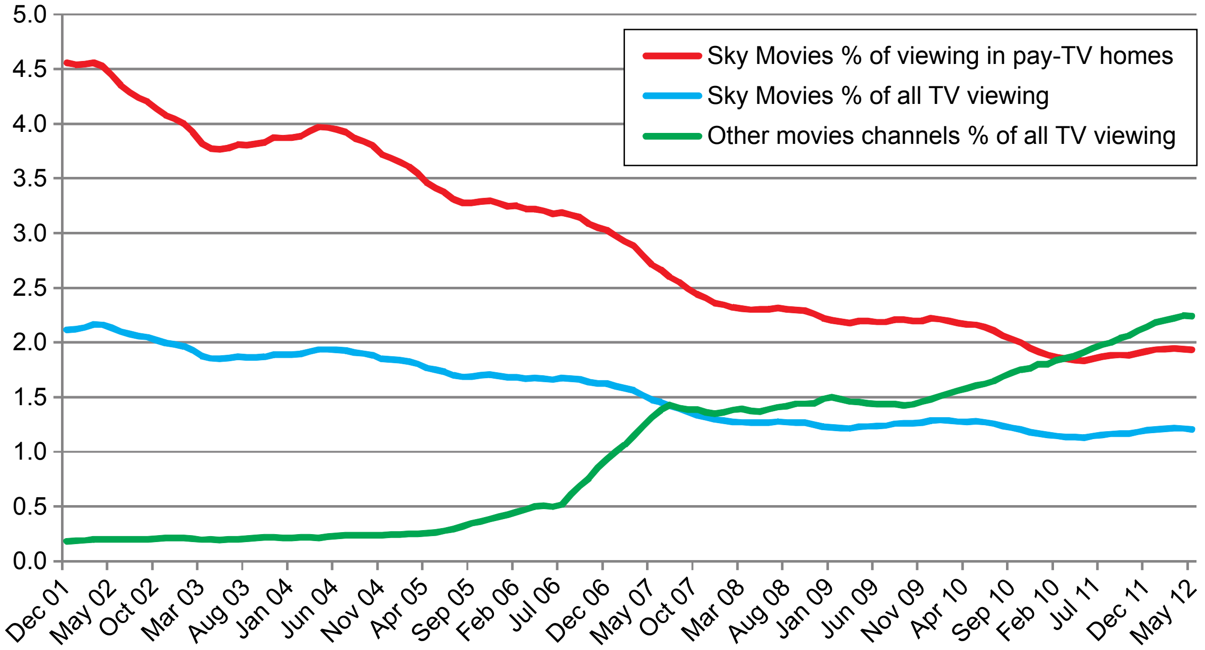
Viewing figures

6.89 Over the past few years, consumers have increasingly watched older movies on free digital multi-channels instead of watching newer movies on subscription pay-TV movie channels (ie principally Sky Movies). As a result, between 2003 and 2010 the number of movie viewings on pay-TV channels declined by more than 30 per cent, from over 800 million to just over 550 million (see paragraph 2.105). Sky Movies now accounts for only around 2 per cent of viewing hours in homes with pay TV[62] and about 1.2 per cent of viewing hours in all homes.[63]

6.90 We compared viewing data for Sky Movies with that for viewing of other movie channels. Figure 6.1 shows the results.

FIGURE 6.1

Viewing data for Sky Movies and other movie channels



Source: Infosys+, BARB (January 2001–May 2012).
Note: Figures are averages for previous 12 months. Sky Movies includes all Sky Movies channels but not Disney Cinemagic. Other movies channels include the following channels: Film4, Film4+1, Film 24, Horror Channel, Horror Channel+1, Movies 24, Movies 24+1, Movies4Men, Movies4Men+1,Movies4Men 2, Movies4Men 2+1, True Movies 1, True Movies 2. The increase in viewing of other movies channels in 2006–2007 was due to the impact on 12-month averages of Film 4 becoming available FTA.

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[62] In our August 2011 provisional findings, we estimated that, based on the average incremental price of Sky Movies, spending on Sky Movies in 2010 represented just over 10 per cent of total spending on pay TV (Appendix 4.11 explains our calculation of the incremental Sky Movies average price). It seemed to us that the higher percentage of spend on pay-TV than viewing attributable to Sky Movies reflected the fact that a proportion of viewing in pay-TV homes was of FTA TV and that subscribers paid an incremental price for Sky Movies, over and above the charge for basic pay TV.
[63] See Figures 2.5 & 6.2.

6.91 Viewing of Sky Movies channels as a percentage of total viewing in pay-TV homes declined sharply until around the end of 2008, after which the trend of decline was less steep. Viewing of Sky Movies channels as a percentage of total viewing in all homes also declined throughout the period, although less sharply than as a percentage of viewing in pay-TV homes (because the proportion of homes without pay TV declined). At the time of our report, Sky Movies accounted for about 1.2 per cent of viewing in all homes.[64] By this time, viewing of movies on other channels (FTA and basic pay-TV) had exceeded that on the Sky Movies channels as a percentage of total viewing. Viewing of movies on LOVEFiLM and Netflix was not included in data (from BARB) but it seemed to us that viewing of movies through these services was likely to have increased rapidly in the months prior to our report, as both services gained new subscribers (see Appendix 4.2).

6.92 In our view, the decline in the level of viewing of Sky Movies was likely to indicate a decline in the significance of Sky Movies to consumers' pay-TV subscription decisions.

Number of Sky Movies subscribers

6.93 In our view, the absolute number of Sky Movies subscribers was not informative as to the significance of Sky Movies (see paragraph 6.33). However, we recognized that a change in the number of consumers subscribing to Sky Movies was likely, other things being equal, to be positively associated with a change in its significance.

6.94 Figure 6.2 shows the monthly number and proportion of Sky's pay-TV customers subscribing to a Sky Movies product since 2000. The percentage of Sky's pay-TV subscribers overall taking Sky Movies [✂] from [✂] per cent at the beginning of 2000 to [✂] per cent in mid-2012. [✂][65]

FIGURE 6.2

Sky Movies subscribers with Sky: percentage (red line on left-hand scale) and number (green line on right-hand scale)

[✂]

Source: Sky.
Note: Sky Movies includes all Sky subscribers who take up a Sky Movies product.

6.95 Over the same period, there was [✂] in the proportion of cable customers subscribing to Sky Movies: from about [✂] per cent at the beginning of 2000 to [✂] per cent at the end of 2011. [✂]

6.96 In our view, the decline in the proportion of pay-TV consumers who subscribe to Sky Movies was likely to indicate a decline in the significance of Sky Movies to consumers' pay-TV subscription decisions. It also appeared to us that this, combined with the viewing trends (see paragraphs 6.89 to 6.92), including the overall increase in viewing figures for movies (driven by more viewing of movies on basic and FTA channels), suggested that there had been a decline in the significance of FSPTW content to consumers' pay-TV subscription decisions.

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[64] About 1.4 per cent if viewing on the Disney Cinemagic channels was included.
[65] [✂]

Views of the studios

6.97 Warner said that, whilst Sky's premium movie content may have helped historically in terms of building its subscriber base, its importance as a driver of pay-TV subscriptions was decreasing as alternative means of accessing movie content and of building attractive consumer retail propositions had developed.

6.98 Disney told us that data on UK viewing habits showed that FSPTW movie content represented a *de minimis* and declining share of UK viewing hours (see paragraph 6.89). Disney said that: *(a)* Sky Movies (which included FSPTW and other movie content) accounted for [✂] all UK TV audience viewing hours (around 3 per cent of viewing hours on all pay-TV channels and [✂] 1 per cent of viewing hours across all pay-TV and FTA channels); *(b)* Sky Movies' share of total UK TV viewing was declining, falling by 25 per cent between 2006 and 2011 (from around 1.6 to 1.2 per cent); and *(c)* by contrast, over the same period (2006 to 2011), the total share of UK viewing accounted for by Sky's channels had increased (from approximately 8.2 to 8.8 per cent). In Disney's view, [✂]. Disney added that, in fact, [✂] (between 2006 and 2011, the share of total UK viewing accounted for by Sky's sports channels, Sky's general entertainment channels and Sky's other channels increased by 13, 11 and 43 per cent respectively).

6.99 Paramount said that [✂], and that this was consistent with there being far greater opportunities to watch movies prior to the FSPTW as a result of increases in home entertainment sales, EST sales, mail-order DVD subscription services, and TVOD sales (see Appendix 2.2). Paramount said that these developments had occurred internationally, noting that [✂]. Paramount said that this evidence was inconsistent with the view that [✂]. In Paramount's view, [✂].

6.100 Universal told us that FSPTW movie content in the USA had become a less significant factor of success for premium pay-TV channels than original programming content, which had rapidly gained in importance over the last decade (for example, the channel provider Showtime did not benefit from exclusive FSPTW rights from any of the major studios but had been able to gain a significant number of subscribers largely on the strength of its original TV programming). Universal said that this trend was already apparent in the UK pay-TV market and appeared likely to accelerate over time (Universal noted Sky's substantial investment in US TV programmes for its Sky Atlantic channel and statements by Sky that it expected the £380 million which it spent on UK commissioning, production and journalism in 2011 to grow by more than 50 per cent to £600 million over the next three years as it commissioned more British programmes).

6.101 In our view, these views were consistent with our conclusions on this issue (see paragraph 6.96).

Market developments through the course of our investigation

6.102 Through the course of our inquiry and, in particular, in the period after our August 2011 provisional findings, there were a number of significant developments in the market. In December 2011 and January 2012 respectively, LOVEFiLM and Netflix launched new OTT services with movie content and, in July 2012, Sky launched Now TV, with Sky Movies the first content made available on this service. Sky also adjusted other aspects of its commercial strategy with regard to movies.

6.103 We considered the relevance of each of these developments to our assessment of the extent to which the availability of Sky Movies and FSPTW movies were significant to consumers' pay-TV subscription decisions.

6.104 Our starting point in the light of the evidence considered so far in this section was that pay-TV movie services and Sky Movies were significant to the subscription decisions of only a relatively small minority of pay-TV subscribers, and FSPTW content an even smaller minority. Therefore, we focused on considering the extent to which the new OTT services of LOVEFiLM and Netflix were likely to be regarded as substitutable for Sky Movies by this group of consumers. We first discuss the evidence in relation to this issue and then discuss the potential impact of Now TV and other initiatives by Sky.

LOVEFiLM and Netflix

6.105 In its Pay TV Statement dated March 2010, Ofcom said (among other things) that it was concerned that services distributing content in new ways (eg SVOD services delivered OTT) may not emerge if potential new entrants could not access attractive content. Just under two years later, LOVEFiLM and Netflix launched new SVOD services with movie content delivered OTT (as described in Section 2). The OTT services of both LOVEFiLM and Netflix combine some FSPTW content from non-major studios with subsequent pay-TV and library window content from both major and non-major studios, alongside previously-broadcast pay-TV programming, and the services are offered to consumers at low prices relative to the incremental price of Sky Movies (particularly when not taken with Sky Sports). As well as having a different delivery mechanism, these movie services offered a broader range of content than was on previously available SVOD services (namely BT's Vision Film and PictureBox).[66] Following their launch, both LOVEFiLM and Netflix experienced rapid growth.

6.106 In our view, the emergence of these new OTT services was relevant to our assessment of the significance of Sky Movies (and FSPTW content) because they potentially offered a further alternative for pay-TV consumers. Previously, consumers who wanted a pay-TV movie service were limited to channels or SVOD services offered by traditional pay-TV retailers. However, following the emergence of these OTT services, consumers could now choose to receive a movie service on an OTT basis while obtaining other pay-TV services (eg a basic package with or without sports) from another provider. Thus, for example, consumers could now, rather than subscribe to a package from Sky including Sky Movies, instead choose another company (eg BT (used in this example because it did not at the time of our report offer Sky Movies)) as their main pay-TV retailer, and also subscribe to the OTT movie service of LOVEFiLM or Netflix. In our view, we needed to assess the extent to which such alternative 'combination' packages were likely to be regarded as substitutable for Sky Movies in particular by consumers for whom the availability of Sky Movies (and FSPTW content) would otherwise have been significant to their choice of traditional pay-TV retailer.

6.107 The results of our December 2010 survey suggested that, in evaluating their movie service, Sky Movies subscribers took into account not only movie recency but also a number of other factors (see paragraph 6.66). Indeed, more Sky Movies subscribers considered the following features to be important than considered the recency of content to be important: the overall cost of the service, the total number of movies available to watch, the minimum length of the contract, the availability of movies in HD, and the number of movies added each week (see Table 6.2). The conclusion that more Sky Movies subscribers valued range than recency was also supported by Ofcom and Sky survey data (see paragraph 6.67). It appeared to us that the relative

[66] PictureBox is available OTT and from Virgin Media, TUTV and Freesat (certain STBs only), and incorporated by BT Vision into its Vision Film offering.

importance of different attributes of a pay-TV movie service to Sky Movies subscribers had to be borne in mind when considering the extent to which the availability of the new OTT services provided Sky Movies subscribers with an alternative.

6.108 We recognized that our data on the extent to which consumers valued different movie service attributes was based on the responses of all Sky Movies subscribers, and did not relate specifically to those Sky Movies subscribers for whom the availability of Sky Movies was, prior to the entry of the new OTT services, significant to their pay-TV subscription decisions. In the light of this, we carried out a further analysis of responses to our December 2010 survey so as specifically to distinguish *(a)* the responses of those who would change their pay-TV subscription if Sky Movies was no longer available; and *(b)* the responses of those for whom Sky Movies was important to their pay-TV subscription decision. Although sample sizes became smaller, this analysis found that the responses of these sub-groups were broadly similar to responses for all Sky Movies respondents. In particular, recency was not materially more important in relative terms (ie relative to other movie service attributes) for consumers for whom Sky Movies was likely to be important to their subscription decisions. The results of this analysis are set out in Appendix 6.4. On the basis of this further analysis, it appeared to us that the results of our survey (based on all Sky Movies subscribers) remained relevant for the purpose of assessing the extent to which the OTT services of LOVEFiLM and Netflix were likely to be regarded as substitutable for Sky Movies by the relatively small minority of customers for whom Sky Movies would otherwise be significant in their pay-TV subscription decisions.

6.109 We considered both the similarities and the differences between Sky Movies and the OTT services of LOVEFiLM and Netflix (see Appendix 4.2). We noted as similarities that all of these services offered a wide range of movies on demand, with at least some in the FSPTW and at least some in HD, and all these services were available on a subscription basis. However, we also found that there were a number of differences. We considered a number of attributes, starting with cost and range, which appeared to be important to the most Sky Movies subscribers, and we set out our findings below. We drew on the description and comparison of the services set out in Section 2 and Appendix 4.2.

6.110 In terms of cost, at the time of our report the monthly subscription prices of LOVEFiLM and Netflix were £4.99 and £5.99 respectively. The incremental price of Sky Movies was £16 for customers who did not take Sky Sports, but was likely to be lower for many customers who did take Sky Sports (eg for customers who valued Sky Sports at or above its stand-alone incremental price (£20), the effective incremental price of Sky Movies was £8).[67] In all cases, the services of LOVEFiLM and Netflix were cheaper than Sky Movies, and for those consumers who did not put a high valuation on Sky Sports they were significantly cheaper.[68] Moreover, we noted that while the price disparity was less for customers who did put a high valuation on Sky Sports, it appeared to us that such customers were less likely to regard Sky Movies as significant in their choice of traditional pay-TV retailer. As regards the total number of movies available to watch on each service: at the time of our report, Sky Movies offered about 850 movie titles in a month, of which around 600 were available to watch on an on-demand basis via Sky Anytime+ and Sky Go (and Now TV); and LOVEFiLM and Netflix offered approximately 3,500 and 1,000 movies respectively,

[67] The price of the dual sports/dual movies pack (£28) less the price of the dual sports pack (£20).
[68] Around [✂] of subscribers to Sky Movies also subscribe to Sky Sports and many of them are likely to value Sky Sports at above its stand-alone incremental price: survey data suggested that about 44 per cent of Sky Movies/Sky Sports subscribers subscribed to Sky Movies because they wanted Sky Sports and Sky Movies did not cost much extra, 26 per cent said they subscribed to Sky Sports because of Sky Movies and Sky Sports did not cost much extra, and 26 per cent said having Sky Movies was as important as having Sky Sports (see Appendix 6.1, Table 1 (Ofcom 2008 Willingness to Pay survey)).

plus thousands of TV episodes. However, we noted that Sky Movies offered a range of many recent movies from the major studios which were not available on the OTT services of LOVEFiLM and Netflix. In comparison with Sky Movies, respondents to our February 2012 survey on average rated the LOVEFiLM/Netflix service broadly on a par with Sky Movies for range of films, but slightly worse on offering 'big hit'/well-known films.[69]

6.111 Our December 2010 survey suggested that the minimum length of contract was very important to around a quarter of Sky Movies subscribers. With regard to this feature, we noted that the services of LOVEFiLM and Netflix did not require an initial contractual commitment, which was in contrast to traditional pay-TV providers such as Sky and Virgin Media (which carry Sky Movies), which typically required initial contracts lasting 12 to 18 months (in order to recover up-front costs associated with installation costs and subsidizing an STB).

6.112 With regard to movie recency (ie the length of time one has to wait after a movie is shown at the cinema before one can watch it on TV), 12 per cent of respondents to our December 2010 survey who subscribed to Sky Movies said that it was very important to their pay-TV subscription decision. We also noted that the fact that movie service providers referred to their FSPTW content in their marketing in order to attract subscribers indicated that this attribute was important to at least some consumers (see paragraph 6.78). We found that Sky Movies offered a clearly differentiated product in terms of recency as it included most FSPTW content (representing around three-quarters of box office revenue for movies released in 2011), including all of the content of the six major studios; while LOVEFiLM and Netflix shared most of the remainder. LOVEFiLM and Netflix also had a significant quantity of SSPTW and TSPTW content, ie movies which were more recent than library movies and most of the movies shown on FTA TV channels but less recent than FSPTW movies.

6.113 Overall, these comparisons suggested to us that the OTT movie services of LOVEFiLM and Netflix were likely to be regarded as substitutable for Sky Movies by some actual or potential Sky Movies subscribers, though we accepted that there would be a number of actual or potential Sky Movies subscribers for whom this would not be the case. We also accepted that the proportion of consumers who regarded the OTT services of LOVEFiLM and Netflix as substitutable for Sky Movies was likely to be greater when considering all Sky Movies subscribers than when considering the group of subscribers for whom Sky Movies would otherwise have been 'significant' (ie those who particularly valued Sky Movies). Nonetheless, in our judgement, the OTT movie services of LOVEFiLM and Netflix were likely to be regarded as substitutable for Sky Movies by some of that latter group too.

6.114 Virgin Media told us that it believed it was very unlikely that subscribers with a high willingness to pay for pay-TV services would regard OTT services as an alternative to Sky Movies. It said that it believed there were significant barriers to de-coupling the choice of movie service from the choice of pay-TV retailer. In particular, Virgin Media noted that: *(a)* entering into two subscriptions would entail administrative hassle; *(b)* consumers might experience a lack of integration between OTT services and their existing pay-TV services; *(c)* the quality of the viewing experience over the Internet could be poor due to insufficient broadband speed; and *(d)* customers might not have

[69] 20 per cent of respondents said that LOVEFiLM/Netflix offered a much better range and 16 per cent said that LOVEFiLM/Netflix offered a much worse range. 37 per cent of respondents said that LOVEFiLM/Netflix offered a range that was much or a little better and 37 per cent said that LOVEFiLM/Netflix offered a range that was much or a little worse. 10 per cent of respondents scored LOVEFiLM/Netflix much better on 'offering films that were big hits/well known' and 14 per cent much worse. 26 per cent of respondents scored LOVEFiLM/Netflix much or a little better on 'offering films that were big hits/well known' and 35 per cent much or a little worse. The remainder of respondents answered 'not sure' or 'the same'. See Appendix 4.3, paragraph 46 & Figure 20.

access to the Internet on their main household TV. We accepted that factors such as these could mean that the OTT services of LOVEFiLM and Netflix were not an effective substitute for Sky Movies for some customers.[70] Nonetheless, it did not appear to us that these factors which potentially inhibited the adoption of the OTT services of LOVEFiLM and Netflix were likely to outweigh all the other positive attributes of these services for all customers.

6.115 Virgin Media also said that subscribers to a package containing Sky Movies and Sky Sports would experience a loss of bundling advantages and that it was entirely implausible that such subscribers would consider the OTT services of LOVEFiLM and Netflix to be an attractive alternative to Sky Movies.[71] We recognized that mixed bundling of Sky Movies and Sky Sports meant that the effective incremental price of Sky Movies for subscribers who valued Sky Sports at or above its stand-alone incremental price was £8, which was only £2 and £3 more than the cost of the OTT services of Netflix and LOVEFiLM respectively. However, in our view such subscribers were less likely to regard Sky Movies as significant to their choice of pay-TV retailer than those who did not subscribe to Sky Sports or who subscribed to the combined Sky Movies and Sky Sports product principally because of Sky Movies (see paragraphs 6.23 and 6.24).

6.116 Virgin Media also told us that the OTT services of LOVEFiLM and Netflix could not be close substitutes for Sky Movies because a significant proportion of their subscribers would be customers who were unwilling to pay for a traditional pay-TV package, or who would subscribe to them in addition to Sky Movies (ie that the OTT services of LOVEFiLM and Netflix should be regarded as complements to, rather than substitutes for, Sky Movies). We agreed that the OTT services of LOVEFiLM and Netflix were not close substitutes for Sky Movies (see Appendix 4.2). However, in our view, some subscribers to LOVEFiLM and Netflix did fall into these categories. Our February 2012 survey found that 65 per cent of the new subscribers to LOVEFiLM and Netflix had a traditional pay-TV service and 20 per cent subscribed to Sky Movies.[72] Of the respondents who subscribed to Sky Movies and intended to continue with their LOVEFiLM or Netflix service, 33 per cent said either that they had already cancelled or that they intended to stop or downgrade their Sky Movies subscription.[73]

6.117 If we applied these percentages to the forecasts from LOVEFiLM and Netflix for the number of their subscribers at the end of 2012, the implication was that, as a result of the competition provided by these services, around [✄] per cent of Sky Movies subscriptions would be stopped or downgraded.[74] If we applied the same percentages to the forecasts from LOVEFiLM and Netflix for the number of their subscribers at the end of 2014, the implication was that about [✄] per cent of Sky Movies subscriptions would be stopped or downgraded. We repeated this analysis just for Sky Movies subscribers who regarded Sky Movies as very or quite important to their pay-TV subscription and the results were broadly similar.[75] We accepted that using survey

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[70] However, in some instances the inconvenience of these factors may not be great. For example, it is relatively easy to subscribe to OTT services online, and switching viewing between OTT and traditional pay-TV services may require consumers to do little more than change channels or TV input (eg as may be required to switch between a TV channel and a DVD). Our views as to the likely impact of limitations in broadband speeds, etc, are set out in Sections 2 & 7.
[71] Virgin Media said such subscribers would lose all of the FSPTW content from the six major studios and that the general entertainment content offered by the OTT service was largely duplicative of content already available in the basic element of the subscriber's existing package.
[72] These figures were similar for respondents who said that they were minded to continue with their subscriptions to LOVEFiLM/ Netflix.
[73] This analysis included those who had subscribed to Sky Movies within the previous three months.
[74] See Appendix 4.2, paragraph 30.
[75] This was because *(a)* more of the respondents to our February 2012 survey with Sky Movies who expected to continue their subscription to LOVEFiLM /Netflix regarded Sky Movies as ‘very’ and ‘very/quite’ important to their pay-TV subscription than did all Sky Movies subscribers based on responses to our December 2010 survey; but *(b)* a smaller percentage of the former than

responses in this way was subject to a number of uncertainties, in particular: *(a)* these early subscribers might not be representative of future subscribers; *(b)* it was likely that these survey responses effectively captured the switching intentions of subscribers before they informed their provider of their intention to switch, some of whom were then likely to be retained, and therefore these figures were likely to overstate the proportion of subscribers who in fact ended up switching; and *(c)* the subscriber forecasts were subject to many uncertainties and in our view could incorporate some degree of appraisal optimism. Nonetheless, it appeared to us that these figures provided some further support to our expectation that at least some Sky Movies subscribers would regard the new OTT services of LOVEFiLM and Netflix as substitutable for Sky Movies.

6.118 Furthermore, we noted that, even if in the short term these figures suggested that the services of LOVEFiLM and Netflix were unlikely to cause a large proportion of Sky Movies subscribers to stop or downgrade their Sky Movies subscription, this was likely in part to reflect the general switching barriers and customer inertia present in the pay-TV market (see paragraphs 5.30 to 5.45), and was not in itself strong evidence that subscribers to Sky Movies would not regard the services of LOVEFiLM and Netflix as substitutable for Sky Movies. While we recognized that switching barriers and the effects of customer inertia were likely to be lower in respect of OTT services than in respect of traditional pay-TV services (see paragraph 5.46), we noted that some switching barriers and inertia effects would continue to operate in respect of a subscriber to a traditional pay-TV retailer choosing between Sky Movies as an incremental product and OTT services.

6.119 BT told us that the OTT services of Netflix and LOVEFiLM were not materially stronger competitors to Sky Movies than the alternative services which were previously available. In particular, BT said that they did not have materially more FSPTW and SSPTW content than its own movies service (Vision Film) previously had. We did not agree. We compared the services of LOVEFiLM and Netflix with BT's Vision Film service both at the time of our August 2011 provisional findings and at the time of our final report and found that the former performed significantly better in terms of the attributes of movie services valued by Sky Movies subscribers:

(a) The OTT services of LOVEFiLM (SVOD only) and Netflix were available at lower prices. They cost £4.99 and £5.99 per month respectively, whereas BT's Vision Film service was marketed principally as part of BT's Vision 'unlimited' package which cost £12.50 per month (plus activation fee and delivery charge for new subscribers). BT told us that Vision Film was also available as a stand-alone pack for £7.20 per month, [✂].[76]

(b) The OTT services of LOVEFiLM and Netflix offered a much larger number of movies. LOVEFiLM and Netflix offered approximately 3,500 and 1,000 movies respectively whereas BT told us that, during April 2012, Vision Film offered about 150 movies at any one time, of which 45 were introduced to the service during the month.[77] The OTT services of LOVEFiLM and Netflix also included thousands of TV episodes.

(c) The OTT services of LOVEFiLM and Netflix involved fewer contractual restrictions. They did not require an initial contractual commitment (and offered 30-day

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the latter group said that they would stop or downgrade; and *(c)* these two factors broadly offset each other. We noted that the sample size of the former group was small and that this added to the uncertainties associated with the exercise.

[76] BT's Vision Unlimited pack included the ESPN sports channel. BT Vision prices were incremental prices for subscribers to BT Broadband.

[77] BT said that Vision Film offered about 600 movies over the course of a year (see Appendix 4.12, paragraph 15).

free trials to prospective users),[78] while a new subscription to Vision Film involved a 12-month contract (and for potential subscribers not already with BT Broadband, a 12- or 18-month broadband contract).

(d) The OTT services of LOVEFiLM and Netflix offered more recent movies in that they included more FSPTW content than Vision Film (both at the time of our report and at the time of our August 2011 provisional findings).[79]

6.120 We also observed that the new OTT services of LOVEFiLM and Netflix had grown very rapidly in comparison with BT's Vision Film service. For example, less than five months after launch, Netflix already had [✂] paying subscribers and a further [✂] users on free trial (of which we would expect around [✂] per cent to become paying subscribers), and, by May 2012, LOVEFiLM had [✂] users of its unlimited streaming service. In contrast, BT's Vision Film had only [✂] subscribers three and a half years after launch.

6.121 Moreover, in our view, the success of the new OTT services was not only due to their attractive content but also reflected that they had a different delivery mechanism and business model to traditional pay-TV providers, and had been launched at a time when technological developments and changes in viewing habits appeared conducive to their success (these factors are discussed in more detail in Sections 2 and 5). For example, unlike traditional pay-TV retailers, providers of OTT services do not need to subsidize and recoup over time the cost of an STB, which allows them to offer their services at a lower price and with no minimum contract period, which are attributes of a pay-TV movie service which many consumers find attractive (see paragraphs 6.63 to 6.66). For these reasons (among others—see Section 7), barriers are likely to be lower in respect of switching to OTT services than in respect of traditional pay-TV platforms. In addition, technological developments mean that a large proportion of people are now able to access OTT services, and consumers are increasingly watching programming OTT on multiple devices. The fact that a number of OTT services have either recently been launched or are imminent suggests that many companies perceive an increasing commercial opportunity to distribute movie content to consumers over the Internet.

6.122 In our view, given *(a)* the differences between previous rival pay-TV movie services to Sky Movies and the new OTT services of LOVEFiLM and Netflix, *(b)* the adoption of these new services to date compared with the success of previous rival services, and *(c)* the developments in technology and the shifts in consumer behaviour which had facilitated the emergence of the alternative form of distribution and business model used by these services, the comparatively poor performance in the past of other movie services was of limited relevance when assessing the extent to which LOVEFiLM and Netflix might be adopted by consumers.

6.123 Notwithstanding these observations, in reaching our findings on this issue we did not assume that either LOVEFiLM or Netflix would achieve their projected numbers for subscriber growth. However, on the basis of the evidence available to us, we expected that at least one OTT movie service in competition with Sky Movies (whether LOVEFiLM or Netflix or an equivalent service) would survive in the market

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[78] Customers must sign a cancellable bank or credit card mandate to enable payments to start at the end of the free trial period (unless cancelled before then).
[79] This point is discussed further in Appendix 4.2 and Appendix 4.12.

in the longer term[80] and would be regarded as substitutable for Sky Movies to a greater extent than the alternative movie services that had previously been available.

6.124 We noted that it was likely that the OTT services of LOVEFiLM and Netflix would be regarded as substitutable for Sky Movies by more consumers if they were available via traditional pay-TV platforms (and switching between services would be easier). [✂], Netflix told us that, [✂].[81] LOVEFiLM told us that [✂]. Overall, we believed it likely that at least some traditional pay-TV retailers would offer an OTT service from either LOVEFiLM or Netflix (or both) in the foreseeable future (though our findings in this section were not dependent on this happening).

Now TV

6.125 Subsequent to the launch of the OTT services of LOVEFiLM and Netflix, Sky has done a number of things. In particular, Sky has *(a)* launched Sky Movies on Now TV; *(b)* reduced the wholesale price [✂]. In this subsection we discuss the launch of Sky Movies on Now TV. In the next subsection we discuss the other changes.

6.126 In July 2012, Sky launched a new OTT service, Now TV, which allows consumers to subscribe to Sky Movies separately from any basic paid-for content and separately from a subscription to any traditional pay-TV service (whether delivered via Sky's platform or one of its rivals).[82]

6.127 As a result, at the time of our report it was possible for a consumer to obtain Sky Movies on an OTT basis and to obtain other non-movie content from other pay-TV retailers. It appeared to us that this possibility had widened the options available for, in particular, the small group of consumers for whom the availability of Sky Movies was significant to their traditional pay-TV subscription decisions, notwithstanding the launch of the LOVEFiLM and Netflix services.

6.128 As discussed above, our December 2010 survey suggested that only around 10 per cent of pay-TV subscribers would switch away from their current pay-TV provider if it stopped supplying Sky Movies (see paragraph 6.40). It also indicated that Sky Movies subscribers valued many attributes of a pay-TV movie service, and tended to value a number of attributes more highly than movie recency (see paragraphs 6.63 to 6.66). For this reason, in our view, some consumers within the group of about 10 per cent for whom Sky Movies was significant in their choice of traditional pay-TV retailer were likely to regard the new OTT services of LOVEFiLM and Netflix as effective substitutes for Sky Movies (see paragraph 6.113). Nevertheless, we accepted that there would be some consumers for whom that would not be the case, including in particular subscribers for whom movie recency (and therefore FSPTW content) was more important than other factors when evaluating competing movie services. In our view, following the launch of Sky Movies on Now TV, a consumer within that sub-group who did not wish to switch to LOVEFiLM or Netflix could now choose to subscribe to a basic pay-TV package from a provider other than Sky (eg BT or Virgin Media) and subscribe to Sky Movies OTT via Now TV.

[80] We had no reason to expect that either Netflix or LOVEFiLM would exit the market in the foreseeable future (see Appendix 4.2).
[81] [✂]
[82] Virgin Media said it understood that Sky was intending to add sports and basic pay-TV content and therefore Now TV would not remain a stand-alone movie service going forward. However, while we expected Sky to add further content to its OTT service (Now TV), we expected Sky Movies to remain unbundled from other content on Now TV and from pay-TV services on a traditional pay-TV platform. This expectation was based on [✂] our observation that linking to a traditional pay-TV platform would be inconsistent with Sky's targeting of Now TV at consumers who did not currently have paid-for TV.

6.129 We noted that *(a)* the content in the Sky Movies subscription product on Now TV was essentially the same as the content in Sky's dual movies product available through the traditional pay-TV platforms of Sky or Virgin Media (in terms of both linear and SVOD content);[83] and *(b)* the Sky Movies product on Now TV cost £15 per month, which was much lower than the price (£32 to £36) that a consumer interested only in Sky Movies previously had to pay to obtain dual movies over the Internet).[84] This price was also slightly lower than the incremental price (£16) of dual movies for Sky subscribers who did not subscribe to Sky Sports, though it was materially higher than the effective incremental price (£8) of dual movies for Sky subscribers who valued Sky Sports at more than its own stand-alone incremental price (see paragraph 6.110 and Table 2.5) (though this latter group of customers was less likely on average to regard Sky Movies as significant to their pay-TV subscription decision (see paragraph 6.110)). We also recognized, though, that subscribing to two different pay-TV retailers would entail some administrative inconvenience (see paragraph 6.115), and not all consumers would have access to a broadband connection adequate for viewing OTT services. In our view, these issues were likely to deter some consumers from subscribing to both a traditional pay-TV provider and Sky Movies on Now TV, but we did not believe that they would deter them all.

6.130 Overall, we believed that the option of subscribing to Sky Movies on Now TV alongside a subscription to a traditional pay-TV platform for other pay-TV services would be regarded as a substitute for subscribing to a package containing Sky Movies on a traditional pay-TV platform for at least some of the sub-group of consumers for whom the availability of Sky Movies was likely to remain significant to their traditional pay-TV subscription, notwithstanding the launch of the LOVEFiLM and Netflix services.

6.131 Virgin Media and BT both told us that Sky had no incentive to reduce its competitive advantage in the traditional pay-TV retail market by offering Sky Movies on Now TV on terms which made it attractive to combine it with a subscription to a pay-TV package of a rival pay-TV retailer, and thereby risk the cannibalization of its satellite platform revenue. However, in our view, this argument essentially assumed that Sky's strategy in respect of Now TV would be driven by the defensive objective of avoiding losing those subscribers for whom Sky Movies would otherwise be determinative in their subscription decision.[85] We did not agree that this was likely to be the case. It seemed to us that any cannibalization risk from the unbundling of Sky Movies from basic pay TV applied only in respect of the relatively small sub-group of consumers for whom the availability of Sky Movies remained significant to their choice of traditional pay-TV retailer, notwithstanding the launch of the LOVEFiLM and Netflix services, and would apply only to the extent that members of this sub-group considered changing their traditional pay-TV subscription. In our view, Sky's strategy in relation to Now TV was not likely to be driven exclusively by considerations relating to this sub-group. In particular, given that the popularity of viewing content on an OTT basis was likely to grow over the next few years (see paragraphs 2.161 to 2.163), it appeared to us that subscription OTT services were likely to be one of the faster-growing areas of the pay-TV retail market. In our view, Sky was unlikely to be willing to risk being left behind in such an area, simply because of a risk of cannibalizing

[83] An exception is that Sky's dual movies pack includes the Disney Cinemagic channel which is not on Sky Movies on Now TV.
[84] £32 via the Sky Go monthly ticket (for basic TV plus Sky Movies), or £36 for Sky's full subscription (Sky's basic TV package plus dual movies (see Table 2.5)). Sky's basic TV package plus single movies (with less movie content than Sky Movies on Now TV) cost £28.
[85] BT also said that the assumption in our revised provisional findings that Sky would offer Now TV on terms which made it attractive to combine it with the pay TV packages of rival TV retailers was speculation, unsupported by fact and at variance to past experience. BT said that we had propounded an unreasonably optimistic view of the positive impact that a launch by Sky of Now TV would have on the competitive landscape in pay TV.

revenue associated with a small sub-group of its existing traditional pay-TV subscribers.[86]

6.132 We believed that Sky's decision to launch Now TV was consistent with a conclusion that recent market developments, including the launch of the LOVEFiLM and Netflix services, had altered the balance of advantage for Sky between conserving its position in traditional pay-TV and maximizing sales of Sky Movies, including via OTT services.[87] We noted that it was also consistent with Sky's submissions to us that the significance of Sky Movies to the subscription decisions of traditional pay-TV subscribers had fallen, and with Sky's decision to reduce the wholesale price of certain of its products which incorporate Sky Movies (see paragraphs 6.136 and 6.137).

6.133 Virgin Media told us that Sky's intention to widen the content available on Now TV beyond Sky Movies was entirely consistent with a strategy of targeting households without a pay-TV service who did not want, and were not willing to pay for, a full Sky DTH service. Virgin Media said that it was not consistent with an objective to encourage customers who would otherwise take a traditional pay-TV service to 'mix and match' their content requirements across platforms. We recognized that Sky's immediate objective was to target households currently without a pay-TV service and that Sky had no wish to encourage mixing of Sky Movies on Now TV with products of rival pay-TV retailers. Nevertheless, we believed that Sky's launch of Sky Movies on Now TV had the effect of making such mixing possible, and we expected some, though by no means all, consumers for whom Sky Movies was significant in their traditional pay-TV subscription decision to take advantage of it.

6.134 Virgin Media also said that it saw Sky's launch of Sky Movies on Now TV not as a competitive response to LOVEFiLM and Netflix but [✂]. We agreed that Sky was no doubt launching Now TV with a view to attracting as many OTT subscribers as possible, subject to any risk of cannibalizing its traditional pay-TV revenue. However, we had no reason to expect Sky to achieve in OTT pay-TV retailing the very large share of subscribers which it had achieved in traditional pay-TV retailing, given in particular the risk of cannibalization of its DTH revenues and its lack of incumbency advantage in OTT retailing (see paragraph 5.157). We discuss OTT competition in Section 5, but we did not reach a conclusion as to how successful Now TV was likely to be in the OTT segment of the market relative to rival OTT services (save that we expected at least one rival OTT movie service to persist in the longer term). For the purposes of our assessment of this area of our theory of harm, we believed that the launch of Sky Movies on Now TV was likely further to reduce the significance of Sky Movies to the subscription decisions of consumers choosing between traditional pay-TV providers.

Other changes

6.135 We noted that, through the course of our inquiry, and particularly in the period following our August 2011 provisional findings, Sky made a number of other changes to its business in relation to Sky Movies.

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[86] In 2010, Ofcom considered a proposal from Sky to launch a limited Sky Movies product at a relatively low price point on DTT, within a service known as 'Picnic'. Ofcom said that its assessment of the Picnic proposal would suggest that Sky would be keen to ensure that the Now TV service did not cannibalize its existing satellite business. We noted Ofcom's views and, in particular, the possible similarities in the objectives of Sky's Now TV proposal and its previous 'Picnic' proposal. However, we were able to form our views on the basis of a broader and more up-to-date base of evidence, including, in particular, [✂].

[87] [✂]

6.136 First, Sky reduced the wholesale price of [✂] (see Appendix 8.1). Sky told us that it had made these changes as it wished to increase the wholesale distribution of Sky Movies on new and existing platforms and it hoped that reducing these wholesale prices would further incentivize other pay-TV retailers to sell Sky Movies. Sky said that this was one aspect of its continuing response to competition, including competition from OTT services, such as those of Netflix and LOVEFiLM.[88]

6.137 It seemed to us that, as with the launch of Sky Movies on Now TV, these wholesale price reductions were at least indicative of a shift in the balance of advantage to Sky between conserving its position in traditional pay-TV and maximizing sales of Sky Movies (ie that it had become more profitable for Sky to seek the wider distribution of Sky Movies rather than to use the availability of Sky Movies to increase its sales of traditional pay-TV packages). For this reason, it appeared to us that they were consistent with a fall in the significance of Sky Movies to the subscription decisions of traditional pay-TV subscribers, whether as a direct result of the new OTT services of LOVEFiLM and Netflix and/or because of how consumer viewing habits and preferences had changed over time.

6.138 Second, Sky told us that it had agreed a two-year agreement to wholesale Sky Movies channels to TalkTalk [✂] (see paragraph 2.95).[89] It appeared to us that this development was consistent with Sky's stated rationale for reducing the wholesale prices of certain of its products incorporating Sky Movies.

6.139 BT told us that it believed the timing of the reductions in Sky's wholesale rate-card prices appeared to be an attempt to pre-empt our investigation.[90] [✂]

6.140 We accepted that it was possible that the progress of our inquiry might have contributed to Sky's decision to reduce its wholesale prices [✂], it appeared to us that the launch of the OTT services of LOVEFiLM and Netflix was also likely to have been a factor. We did not reach a view on which factor was likely to have been more important. In our view, Sky's launch of Sky Movies on an unbundled basis on Now TV (ahead of other content becoming available on Now TV) was unlikely either to have been influenced by our inquiry or to be quickly reversed (eg because of the public commitment made and the costs incurred to date). For this reason, in assessing the balance of Sky's incentives, we placed more weight on the launch of Sky Movies on an unbundled basis on Now TV than on Sky's reductions in certain of its wholesale prices.

6.141 We asked BT (which does not currently retail Sky Movies)[91] and Virgin Media (which does retail Sky Movies) how they had responded to the wholesale price reductions.

6.142 BT said that [✂].[92] In our view, this last point was consistent with our analysis, given that the attraction of combined movies and sports products derived more from the sports than the movies element (see paragraphs 6.23*(b)* and *(c)*, 6.33*(a)*, 6.45, 6.54 and 6.110).

6.143 Virgin Media said that Sky's wholesale price changes were complex and that, among other things, while the wholesale prices for [✂] had been reduced [✂], the wholesale price for [✂]. Virgin Media said that, if it were to reduce its retail prices to drive

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[88] Sky said that, [✂].
[89] Sky told us that [✂].
[90] BT said that, over the course of [✂] years of negotiations, [✂]; yet, following the publication of our working papers, and again following the publication of our August 2011 provisional findings and remedies notices, [✂]. BT noted that, at the same time, Sky had been unwilling to reduce its rate-card prices for any other wholesale product.
[91] [✂]
[92] [✂]

growth in subscriptions to Sky Movies, it would run the significant risk that Sky could [✂].[93] More generally, Virgin Media said that its ability to adopt a forward-looking strategy and to make the marketing and other investment necessary to launch innovative offers to customers was limited by a lack of certainty over its terms of wholesale supply.

6.144 We recognized that [✂].[94] Nevertheless, we noted that [✂]. Moreover, we noted that, following the changes to Sky's wholesale prices, Virgin Media's incremental retail prices for single movies and dual movies were about [✂] and [✂] per cent respectively of the wholesale prices it paid, while its incremental retail prices on max sports and dual movies/max sports were about [✂] and [✂] per cent respectively of the wholesale prices it paid.[95] We also noted that Virgin Media's incremental retail prices for movies-only products remained well above Sky's incremental retail prices (£19.50 versus £16 for dual movies and £14.50 versus £8 for single movies).

6.145 In our view, if Sky Movies was significant to consumers' choice of traditional pay-TV retailer, [✂]. In our view, the fact that [✂] tended to support the evidence that Sky Movies was not significant to consumers' choice of traditional pay-TV retailer. We also believed that the fact [✂].[96]

6.146 Virgin Media said in its response to our revised provisional findings that we had not taken into account [✂]. However, in our revised provisional findings we had taken this into account.[97] We also noted, though, that Virgin Media's average incremental retail margin depended on retail prices and volumes as well as wholesale prices, and hence depended on Virgin Media's response to Sky's wholesale price changes. In our view, the important points were that: *(a)* [✂]; and *(b)* [✂]. We believed that the former point suggested that [✂]. We believed that the latter point suggested that [✂].

6.147 Virgin Media also said that, if it shared our perspective on how subscribers would choose their pay-TV packages and movie services in the future, [✂]. However, we observed that Virgin Media [✂]. Hence, in our view, [✂] had no implications for the significance of FSPTW content to consumers' choice of pay-TV retailer.

6.148 As a third change in Sky's business in relation to Sky Movies, we noted that [✂].[98] In our view, this was consistent with the OTT services of LOVEFiLM and Netflix being regarded as substitutable for Sky Movies by at least some consumers who would otherwise subscribe to Sky Movies via a traditional pay-TV platform.

Assessment and findings

6.149 In Section 3, we identified four circumstances which we would expect to be present were our theory of harm to be correct. The second of these circumstances was that

[93] [✂]
[94] [✂]
[95] See Appendix 8.1.
[96] We would expect a traditional pay-TV retailer to be more likely to charge a low price (relative to cost) for 'significant' products in order to attract consumers to their pay-TV platform, and to charge a relatively high price for products that are less 'significant'.
[97] This was specifically referred to in paragraph 6.106*(b)* of our revised provisional findings. We understood that [✂].
[98] See Appendix 4.2. Virgin Media told us that [✂], and BT told us that the entry of Netflix and the launch of LOVEFiLM Instant [✂].

pay-TV movie content in the FSPTW was significant to consumers in choosing their traditional pay-TV retailer.[99] This is the issue that we have discussed in this section.

6.150 The parties highlighted and sought to interpret different pieces of evidence in support of their respective positions: Sky's competitors contended that the available evidence indicated that FSPTW movie content was significant, whereas Sky and the movie studios contended the opposite. We had to form our own views as to what weight to place on, and how to interpret, different pieces of evidence. Our views as to the significance of FSPTW content have changed since our initial provisional findings in August 2011, taking account in particular the market developments since that time. In this subsection we summarize our final conclusions on this area of our analysis.

6.151 Over recent years the number of viewings of Sky Movies has been falling and, by the time of our report, Sky Movies accounted for only a little more than 1 per cent of all TV viewing and 2 per cent of viewing hours in pay-TV homes. Around two-thirds of subscribers said that they first subscribed to pay-TV in order to access a greater choice (range) of TV programming compared with that on FTA channels. Relatively few respondents said that they had initially subscribed in order to watch a wider range of movies. The number of respondents who had initially subscribed in order to watch more movies was broadly the same as those who had subscribed in order to access more children's programmes, and was substantially less than the number who had initially subscribed to watch more sports.

6.152 This provided the context for the next step in our analysis, which was to consider the significance of Sky Movies to a consumer's choice of traditional pay-TV retailer, ie the extent to which consumers were reluctant to switch to pay-TV retailers that did not offer Sky Movies. We undertook this analysis because, while access to a better or wider range of movies may be significant to some consumers when deciding whether to switch pay-TV provider, this would be relevant to our theory of harm only to the extent that traditional pay-TV retailers could not compete effectively with Sky for pay-TV customers as a result of being unable to offer the FSPTW movie content on Sky Movies, and this would only be the case if the overall Sky Movies offering was significant to consumers' traditional pay-TV subscription decisions.

6.153 The results of our December 2010 survey suggested that only around 10 per cent of all pay-TV subscribers would stop paying for their current pay-TV subscription if their subscriber stopped offering Sky Movies. We appreciated that it was possible to argue (as parties did) that the results of this survey could under- or overstate the proportion of Sky Movies subscribers for whom the availability of Sky Movies was significant to their traditional pay-TV subscription decisions, and we did not attach any great importance to the precise figure of 10 per cent (ie our conclusions would not be any different if the true figure were a few percentage points higher or lower). Nonetheless, we believed that this survey indicated that the availability of Sky Movies was significant to the traditional pay-TV subscription decisions of only a relatively small minority of all traditional pay-TV subscribers.

6.154 Other evidence supported this conclusion. In particular, our December 2010 survey also suggested that only around 6 per cent of all traditional pay-TV subscribers regarded Sky Movies as very important in their decision to have a traditional pay-TV service, and 11 per cent considered it quite important. In addition, Ofcom evidence suggested that the availability of Sky Movies was important to fewer consumers than the availability of Sky Sports, Sky 1 and the Discovery Channel, and to approximately

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[99] Our concern was with the significance of *Sky's* FSPTW movie content to consumers' choice of *traditional* pay-TV retailer because Sky had the majority of FSPTW content and the ineffectiveness of competition in the pay-TV retail market derived from Sky's position in traditional pay-TV retailing.

the same number as the availability of several other channels, specifically National Geographic, Nickelodeon Jr, Hallmark, Sci-Fi and the Cartoon Network. Sky's evidence also indicated that Sky Movies was significant to the subscription decisions of far fewer subscribers than Sky Sports. An analysis of the proportion of Sky's marketing budget attributable to Sky Movies was also consistent with Sky Movies being of limited significance.

6.155 Overall, the evidence suggested that the availability of Sky Movies was significant to only a relatively small minority of pay-TV subscribers.

6.156 However, the issue which we were ultimately seeking to address in this section was the significance of FSPTW content to consumers in their traditional pay-TV subscription decisions, rather than the significance of Sky Movies. Therefore, we considered the extent to which different attributes of movie services, and in particular recency, were valued by the relatively small minority of pay-TV subscribers for whom Sky Movies was likely to be significant to their pay-TV subscription decisions.

6.157 Our December 2010 survey asked Sky Movies subscribers what attributes of movie services were 'very important' to them. 12 per cent of Sky Movies subscribers regarded the 'length of time you have to wait after a movie is shown at the cinema before you can watch it on TV' as a very important attribute of a TV movie service. However, this attribute was very important to considerably fewer consumers than several other movie service attributes, including the overall cost of the service (which was the most important factor), the availability of movies on demand, the availability of the service on a subscription basis and the minimum length of contract. In addition, the total number of movies available to watch (ie range) was considered to be very important by considerably more consumers than movie recency: 26 per cent of consumers considered range of movies to be very important, more than double the proportion (12 per cent) who thought that movie recency was very important. An analysis of the proportion of Sky Movies subscribers who considered different movie service attributes to be 'quite important' provided similar results, ie movie recency was considered to be quite important by fewer subscribers than other movie service attributes. While these results related to all Sky Movies subscribers, the relative weight placed on movie recency was not materially different for the sub-group of Sky Movies subscribers who said that the availability of Sky Movies was important to their pay-TV subscription decisions.

6.158 Ofcom and Sky survey data was consistent with the evidence from our December 2010 survey, though evidence from a BT survey was more mixed.[100] We considered trends in DVD and TVOD prices but we did not believe that much could be inferred from this evidence about the preferences of consumers of subscription pay-TV movie services. We also noted that recent evidence on subscriber numbers and viewing habits was consistent with the significance of Sky Movies and FSPTW content having declined over time.

6.159 Overall, the evidence suggested that the availability of Sky Movies was significant to only a relatively small minority of pay-TV subscribers and, further, that many consumers within this sub-group placed more weight on other factors than on Sky Movies' FSPTW movie content (ie they valued other attributes of Sky Movies more). We also noted that Sky's rivals were able to match or better several of these other important attributes, eg by offering lower prices, a larger number of movies, etc. This conclusion constituted an important building block of our overall conclusion in this

[100] See paragraphs 6.67 & 6.68.

area. In our view, the significance of FSPTW movie content was marginal even before we took into account the implications of recent market developments.

6.160 As to those recent market developments, the first was the launch of movie services delivered OTT by LOVEFiLM and Netflix. In our view, at least some of the small minority of pay-TV consumers for whom Sky Movies would otherwise be significant to their traditional pay-TV subscription decisions were likely to regard the OTT services of LOVEFiLM and/or Netflix as substitutable for Sky Movies. We formed this view in the light of the different attributes of the products and in the light of the survey evidence which indicated the extent to which different movie service attributes were valued by Sky Movies subscribers. In particular, while Sky Movies had considerably more FSPTW content, the rival OTT services of LOVEFiLM and Netflix were significantly cheaper and offered a larger number of movies (as well as some FSPTW content). They also did not require a minimum contract period, which we noted was an important factor for some subscribers.

6.161 Notwithstanding this view, though, we recognized that there would be some within this small minority of pay-TV consumers who were unlikely to regard the OTT services of LOVEFiLM and/or Netflix as substitutable for Sky Movies. These may be, for example, some of the consumers who regarded movie recency as being very important (and more important than other movie service attributes) to their choice of movie service, or for whom the disadvantages in taking out two pay-TV subscriptions, one of which is an OTT movie service, were influential.

6.162 In respect of this group of customers, which in our view was likely to be even smaller relative to all pay-TV subscribers,[101] we considered the likely implications of the launch of Now TV, which enabled consumers to subscribe to Sky Movies separately from any basic paid-for content and separately from a subscription to pay-TV services on a traditional pay-TV platform (whether Sky's platform or one of its rivals).[102] As a result, subscribers within this small sub-group could now obtain Sky Movies from Sky on Now TV while obtaining other non-movie content from other traditional pay-TV retailers. Again, we did not believe that all consumers within this sub-group would regard this as an effective substitute for subscribing to Sky's platform and a package containing Sky Movies, but in our view some would be likely to do so. We noted, in particular, that the movie content on Now TV was very similar to that within Sky Movies packages, and also that the price of Sky Movies on Now TV was similar to the incremental price of Sky Movies for subscribers to traditional pay-TV platforms who did not subscribe to Sky Sports.

6.163 Overall, in the light of the attributes of TV movie services which appeared to be important to subscribers, and the recent entry into the market of the OTT movie services of LOVEFiLM, Netflix and Now TV, it appeared to us that only a very small minority of all pay-TV subscribers were likely to regard the availability of the FSPTW content on Sky Movies as significant to their choice of traditional pay-TV provider. As a result, in our view, taking into account these market developments, rival providers were unable to contest at most only a very small proportion of the overall pay-TV market as a result of Sky's position with regard to FSPTW rights.

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[101] That is, smaller than the group for whom Sky Movies would have been significant prior to the launch of the LOVEFiLM and Netflix services.

[102] Virgin Media said it understood that Sky was intending to add sports and basic pay-TV content and therefore Now TV would not remain a stand-alone movie service going forward. However, while we expected Sky to add further content to its OTT service (Now TV), we expected Sky Movies to remain unbundled from other content on Now TV and from pay-TV services on a traditional pay-TV platform. This expectation was based on [✂] our observation that linking to a traditional pay-TV platform would be inconsistent with Sky's targeting of Now TV at consumers who did not currently have paid-for TV.

6.164 The above reasoning was based to a large extent on available survey evidence. However, this was not the only type of evidence to which we had regard. In particular, we also took into account the fact that the pay-TV market appeared to be in the middle of a period of change. In relation to the importance placed by consumers on different types of content when making traditional pay-TV subscription decisions, Sky told us that over time movies had dropped down the list in terms of importance, and that this was particularly true for '[✂]'. While we were aware of the need to be cautious in placing weight on such representations, given that Sky and the other parties had an interest in the outcome of our investigation, we noted that recent viewing and subscription trends were consistent with this submission. In relation to the extent to which consumers were likely to regard OTT movie services as substitutable for Sky Movies, and the likelihood of these services being sustainable over the longer term (and performing better than the rival movie services which were available previously, distributed over traditional pay-TV platforms), we had regard to the fact that recent technological changes meant that a large proportion of consumers already had access to OTT services, that switching barriers were likely to be lower in respect of OTT services than for traditional pay-TV services and, further, that the popularity of viewing programming OTT was likely to grow over the next few years. It appeared to us that the recent decisions by Sky to launch Now TV and to reduce the wholesale prices of certain of its products which incorporate Sky Movies were consistent with these trends, and with a conclusion that the significance of Sky Movies had declined.

6.165 Overall, taking into account all the evidence and findings set out above, including that only a very small minority of all pay-TV subscribers were likely to regard the availability of FSPTW content as significant in choosing (or deciding whether to stay with) a traditional pay-TV retailer, and given the developments in the market which occurred through the course of our inquiry, we concluded that FSPTW content was not significant to consumers in their choice of traditional pay-TV retailer for the purposes of this part of our theory of harm.

6.166 We now comment on four issues which relate especially to this area of our analysis.

6.167 The first issue is that we reached our conclusion on this area notwithstanding that there would be some subscribers who were likely to continue to regard Sky Movies' FSPTW content as being significant to their traditional pay-TV subscription decisions. Our guidelines on market investigation references recognize that 'Inevitably a degree of judgement is involved in deciding whether there are adverse effects on competition. Where the line is to be drawn has to be judged in each individual case in the light of all the evidence that has been assembled in the course of the investigation'.[103] This was our approach to our assessment of this issue. In our judgement and taking into account all the evidence we saw, and notwithstanding that we had found Sky to have market power in the pay-TV retail market, the fact that a group of consumers which was very small relative to the market as a whole considered the FSPTW content on Sky Movies to be significant to their choice of traditional pay-TV retailer did not justify a conclusion that the 'significance' part of our theory of harm was satisfied. The context for this judgement was that, as stated in our market investigation guidelines, 'the Commission sees competition as a process of rivalry between firms'.[104] The process of competitive rivalry in a market is not necessarily undermined simply because there are some consumers who are wedded to a particular product and are as a result unwilling to switch away from a particular provider, and that is particularly the case where the relevant group of consumers is small relative to the market as a whole. In our view, Sky's FSPTW rights were very important to

[103] *CC3*, paragraph 1.20.
[104] *CC3*, paragraph 1.16.

the subscription decisions of a relatively very small group, and even then customers within that group were likely to balance at least to some extent the desirability of being able to view FSPTW content against other factors, such as the price and over-all range of content of rival pay-TV providers.

6.168 Second, we reached our views on significance notwithstanding our findings in Section 5 that the pay-TV market was characterized by ineffective competition, due to a number of features including barriers to switching and customer inertia. These findings provided the context for our analysis in this section, and we took them into account in our assessment (eg in considering whether FSPTW content may be significant to consumers in the light of how it is bundled with other types of content). However, even in the light of this broader perspective, in our view FSPTW content was not significant to a sufficient proportion of consumers in choosing (or deciding whether to stay with) their traditional pay-TV retailer for the ineffectiveness of competition in pay-TV retailing to be attributable to market features relating to FSPTW content.

6.169 Third, in response to our revised provisional findings, BT described some of our reasoning as 'supposition, speculation and assertion about the future which is unsupported by fact and at variance to past experience'. However, in our view, there were many reasons why the performance of previously available movie services, which were distributed over traditional pay-TV platforms, were not a good guide to how OTT services were likely to perform in the future (see paragraphs 6.119 to 6.122). More generally, our reasoning was based on developments which had already taken place, albeit in some cases only recently, ie the launch of the OTT movie services of LOVEFiLM, Netflix and Now TV. Although only recent, it was clear that these developments were relevant to our analysis, and we could not ignore or attribute no weight to them simply because we had less evidence relating to them than in respect of the (now changed) circumstances before they were launched. Therefore, we exercised our judgement and formed a view as to their likely implications in the light of the evidence available. In particular, while the launch of Sky Movies on Now TV occurred too recently for us to take into account evidence on its early performance, we commissioned a survey in February 2012 which provided us with data in relation to the OTT services of LOVEFiLM and Netflix. We acknowledged a number of issues concerning the interpretation of the data, including that responses of early subscribers may not be representative of future subscribers and, with those caveats in mind, we did not rely on the results of that survey in isolation; however, we did place some weight on the results of this survey which we considered alongside other evidence to form a view as to the likely implications of these services for competition.

6.170 In making our assessment, we recognized that it was not possible to reach precise conclusions as to how developments would ultimately turn out in the future, and therefore we exercised caution accordingly. In particular, when making a judgement as to whether the recent market developments which we had observed were likely to persist, we sought only to rely on broader conclusions which we believed were clearly justified by the evidence already available. In general, we found that it was more likely than not that these market developments would persist (in one form or another) rather than that they would be quickly reversed. For example, our analysis did not rest on any precise prediction as to the likely subscriber numbers of LOVEFiLM and Netflix in, say, two years, but it did rely on a much broader conclusion that at least one OTT movies service in competition with Sky Movies (whether LOVEFiLM or Netflix or an equivalent service) would survive in the market in the longer term.

6.171 Moreover, as noted above, the developments on which we relied had already occurred and changed the competitive landscape, even if it was impossible to be certain as to their precise future implications. In particular, the OTT movie services of LOVEFiLM, Netflix and Now TV had already launched. As a result, as of the date of our report, any consumers who were considering changing their traditional pay-TV subscription or taking out a traditional pay-TV subscription for the first time had the option of subscribing to these OTT services.[105]

6.172 Furthermore, a substantial part of our analysis on this part of our theory of harm was based on considerations other than those relating to the recent market developments (see in particular paragraphs 6.21 to 6.101).

6.173 Fourth, in the event that our broad expectations as to the likely persistence of recent market developments were subsequently proved wrong by future events, we recognized that such events may amount to a material change of circumstances that, either on their own or alongside other developments, could warrant renewed scrutiny by Ofcom. In particular, in addition to our expectation that at least one OTT movies service in competition with Sky Movies would remain in the market in the longer term (see paragraph 6.170), we also put weight on the expectation that Sky was likely to continue to offer Sky Movies on Now TV (or an equivalent service) on an unbundled basis,[106] including by enabling consumers to subscribe to Sky Movies separately from any other pay-TV content and separately from a subscription to pay-TV services via a traditional pay-TV platform (whether Sky's platform or one of its rivals). In light of Sky's position in the pay-TV retail market and also recognizing the fast-moving nature of the market, we expected Ofcom to keep developments in this sector under review.

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[105] Assuming that they had access to an adequate broadband Internet connection and a suitable device on which to access the service.
[106] We regarded bundling as including: *(a)* imposing a buy-through requirement (tied sale), ie only selling Sky Movies when another product (eg basic pay TV) was also purchased; *(b)* mixed bundling, ie offering Sky Movies and another product (eg Sky Sports) at a lower combined price than they were offered separately; and *(c)* pure bundling, that is not selling Sky Movies as a separate product at all, ie only selling it as part of a package with other products. The full implications of any one of these developments would depend on the precise circumstances.

7. Barriers to the acquisition of FSPTW movie rights

Introduction

7.1 In Section 6, we set out our assessment of the significance of FSPTW content (in particular, the FSPTW content on Sky Movies) to consumers' choice of traditional pay-TV retailer in the light of all of the evidence and submissions we received, including in relation to the market developments which occurred during the course of our inquiry. We found that FSPTW content was not significant to consumers' choice of traditional pay-TV retailer.

7.2 As part of this assessment, we considered the extent to which the OTT services of Netflix and LOVEFiLM were substitutes for Sky Movies. In that context, we considered the content rights which each of these OTT pay-TV retailers had acquired and the content they were offering at the time of our report (see Appendices 4.2 and 4.12). In reaching our finding on significance, we did not rely on any expectation that either Netflix or LOVEFiLM (or any similar service that might become available in the longer term)[1] would offer a superior content proposition (in terms of range or recency) than either Netflix or LOVEFiLM did at the time of our report.

7.3 We observed that, between them, Netflix and LOVEFiLM had already signed exclusive FSPTW agreements with most of the large non-major studios. We noted that, in at least one case, [✂].[2] This evidence suggested that there were no material barriers to the acquisition of FSPTW content from the majority of non-major studios. We also observed that Netflix and LOVEFiLM had acquired a significant amount of content in other windows from both major and non-major studios, [✂]. This suggested that there were no significant barriers to OTT distributors acquiring content in other windows, and indeed we received no evidence in the course of our inquiry to suggest otherwise. Overall, there appeared to be no barriers to acquiring content such as to prevent the OTT services of LOVEFILM and/or Netflix from maintaining their offering (or an equivalent service developing a similar proposition in the event that either or both LOVEFiLM and Netflix were to exit), which we had found to be a substitute for some subscribers to Sky Movies (see Section 6).

7.4 Accordingly, it appeared to us that any further assessment of barriers was not necessary in order to conclude that the theory of harm set out in paragraph 3.6 was not satisfied. However, as part of our inquiry into the market which was referred to us, we have throughout considered a number of issues relating to the extent to which there are barriers to acquiring movie content in the FSPTW.[3] In our view, it was appropriate to report our analysis and findings on some of these issues notwithstanding our finding on significance.

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[1] In Section 6, we said that, on the basis of the evidence available to us, we expected at least one OTT movie service (whether LOVEFiLM or Netflix or an equivalent service) to survive in the market in the longer term in competition with Sky.

[2] We recognized that Netflix and LOVEFiLM acquired these rights at a time when Sky held the FSPTW rights to all six of the major studios and that, were Sky to lose the FSPTW rights of a major studio to one of Netflix or LOVEFiLM, it might increase competition for the FSPTW rights of non-major studios. However, such a scenario would only come about due to increased rivalry in relation to major studio FSPTW content and, in such a scenario, it was unclear to us whether Sky would in fact be able to outbid Netflix/LOVEFiLM for non-major studio FSPTW content.

[3] We did so not least because in our August 2011 provisional findings we provisionally found FSPTW content to be significant to consumers' pay-TV subscription decisions, and we continued to consider our position on this issue of significance throughout the inquiry, including in the light of responses to our revised provisional findings. If FSPTW content was significant to pay-TV subscription decisions, this would have implied that it was necessary for Sky's pay-TV rivals to offer a movie service similar to Sky Movies (in terms of its FSPTW content) to be able to compete effectively with Sky in the pay-TV retail market. Appendix 7.1 sets out the evidence we considered in this respect in our August 2011 provisional findings, having regard to our provisional analysis of significance and barriers to the acquisition of FSPTW content, along with a discussion of the submissions we received on those issues.

7.5 Given our finding that each of the OTT services of LOVEFiLM and Netflix was a better substitute for Sky Movies than any other subscription pay-TV movie service previously available (eg BT's Vision Film and PictureBox), and [✂], we focused in our assessment on the prospects of LOVEFiLM and Netflix in acquiring further content. We also concentrated on FSPTW content from the major studios because we observed that if one or more OTT pay-TV retailers were to acquire the FSPTW rights of a major studio, this would further increase the extent to which its OTT service was a substitute for Sky Movies, and further reduce the already very small proportion of consumers for whom the FSPTW content on Sky Movies was significant in their choice of traditional pay-TV retailer (see Section 6).[4]

7.6 This section is structured as follows. After providing an overview of our findings in this section, we first provide an overview of the bidding and licensing process for FSPTW rights from the major studios, in which we address *(a)* how rights to content in the FSPTW are licensed; *(b)* the factors which influence bidding; *(c)* evidence from negotiations for major studio FSPTW rights; and *(d)* evidence from LOVEFiLM and Netflix's engagement with non-major studios over FSPTW rights. Second, we assess whether there are barriers to pay-TV retailers (other than Sky) obtaining FSPTW content from the major studios. In doing so, we:

(a) consider the evidence relating to recent negotiations for rights;

(b) summarize our assessment of the barriers facing traditional pay-TV retailers;

(c) assess the role of complementarities in relation to the FSPTW rights of the major studios; and

(d) assess the barriers facing OTT pay-TV retailers.

7.7 Finally, we provide an overall assessment of whether there are barriers to pay-TV retailers (other than Sky) obtaining FSPTW content from the major studios.

Overview of our findings on barriers

7.8 By way of overview, we found that, in the past, traditional pay-TV retailers faced barriers to acquiring the FSPTW content of major studios. It appeared to us that the key problem was that they were unable to be sufficiently confident of being able to reach enough subscribers to justify a bid greater than Sky's. However, in light of our conclusions in relation to OTT pay-TV retailers (see paragraphs 7.176 and 7.177), we did not reach a definitive view on whether traditional pay-TV retailers were likely to continue to face the same barriers in the future. This was because, for the purposes of our assessment, we were not concerned with the prospects of a specific type of pay-TV retailer and the acquisition of major studio FSPTW content by an OTT pay-TV retailer would increase the extent to which this OTT service was a substitute for Sky Movies.

7.9 We found that an OTT pay-TV retailer, such as LOVEFiLM or Netflix, was likely to face fewer difficulties than a traditional pay-TV retailer in attracting subscribers to its movie service because it could generate new consumption from the large pool of potential customers who were not currently pay-TV subscribers and also because it was likely to be more effective in encouraging current traditional pay-TV subscribers

[4] Acquiring further FSPTW content from non-major studios and SSPTW content from major studios might also be expected further to increase the extent to which these OTT services were substitutes for Sky Movies. However, we noted that, between them, Netflix and LOVEFiLM had already signed exclusive FSPTW agreements with most of the large non-major studios and SSPTW agreements with most of the major studios.

to take up its service, whether they considered it to be a complement to their existing traditional pay-TV subscription or a substitute. While we could not be certain of the commercial incentives of any OTT pay-TV retailer to participate in any given auction process and ultimately to make the necessary investment to win, [✂].

7.10 We therefore found, on the basis of the evidence available, that:

(a) although Sky continued at the time of our report to have some advantage compared with its rivals when bidding for rights, the barriers faced by OTT pay-TV retailers in acquiring FSPTW content were lower than for traditional pay-TV retailers;

(b) the barriers faced by OTT pay-TV retailers were likely to erode further; and

(c) there was a realistic prospect that an OTT pay-TV retailer would be able to outbid Sky for the FSPTW rights of at least one major studio in the future.[5]

7.11 We also observed (although our decision did not rest on this) that, if one or more OTT pay-TV retailer acquired the FSPTW rights of a major studio,[6] this would further increase the extent to which its OTT service was a substitute for Sky Movies, and further reduce the already very small minority of pay-TV subscribers for whom the FSPTW content on Sky Movies is significant in their choice of traditional pay-TV retailer (see Section 6).

The bidding and licensing process for FSPTW rights

How rights to exhibit movies in the FSPTW are licensed

7.12 Movie rights are licensed following separate negotiations between one or more interested licensees and an individual studio. These negotiations typically take place before the current agreement to license the movie rights expires, [✂], but there does not appear to be a specific date at which negotiations 'open' and there is no formal process that is adopted. Table 7.1 shows the expiry dates of Sky's current contracts with the six major studios.

TABLE 7.1 **Expiry dates of Sky's current contracts with the six major studios**

Major Hollywood studio	*Start date*	*Expiry date*	*Time until following studio's agreement expires*
[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]

Source: Sky.

[✂]

7.13 In order to understand what is typically involved in the process of acquiring FSPTW rights, early in our inquiry we asked the major studios to tell us about the last few occasions on which they had licensed their movies for exhibition in the FSPTW in the UK (this evidence is summarized in Appendix 7.2).

[5] [✂]
[6] [✂]

7.14 From their responses we understood that, generally, a studio will approach a potential licensee(s) to invite an expression of interest, sometimes by sending the potential licensee an initial proposal. A potential licensee may also approach a studio to express interest in acquiring rights. [✄] Following the initial approach, there is typically a period of negotiation, in which the studio will enter into discussions with an interested party, with a view to obtaining a formal offer.[7] From the evidence we saw, [✄].

7.15 It did not appear that the potential licensees who decide to express interest or submit formal offers necessarily do so on the same basis. Rather, it appeared that there are many aspects of the offer which are subject to negotiation and which may vary between bidders. For example, we noted that [✄], whilst [✄]. In addition, the contract length, the ability to extend the term, output commitments, the payment structure, and restrictions on both parties, ie in terms of how the licensor can exhibit the content (both time and format) and in how the licensee can license rights to the content to other parties (both time and format), are just some of the factors which can vary between bids. [✄]

7.16 A movie studio's ultimate objective is to license its portfolio of movies in such a way that it maximizes the value it obtains over the life cycle of the portfolio, ie across all movie distribution windows. In this context, it appeared to us that a movie studio will assess the bids it receives for its FSPTW rights on the basis of which is most likely to maximize its overall income. Accordingly, a studio will take into account how accepting a bid will impact on its income from other forms of distribution either in the same window or in other windows, which will depend upon factors including the degree to which the exposure under a prospective arrangement for licensing its content to a given licensee could result in lost income from other streams. A studio may also take into account how its content will be marketed and utilized under a prospective arrangement and how accepting a bid will influence the terms under which any other channels it distributes are carried.[8]

Factors which influence bidding

7.17 It seemed likely to us that, in order for a rival to put together a more attractive offer than Sky for a major studio's FSPTW rights (whether it be a traditional pay-TV retailer, aggregator wishing to distribute via traditional pay-TV retailers or an OTT pay-TV retailer), it would need to pay at least as much as Sky.[9] Indeed, it is possible that a rival may need to offer more than Sky, in terms of licensee fees, if a studio perceives that distributing via Sky will deliver marketing benefits or enable them to secure better terms for the distribution of any channels it distributes on Sky's DTH platform. If rivals are incapable of justifying a bid that is valued, in the round, to be at least as high as Sky's, then the underlying reasons for this would constitute barriers to acquiring FSPTW movie content from the major studios.

7.18 In general, the maximum amount that a rival bidder will be willing to bid for FSPTW content will depend on the incremental impact on its long-term profitability of including this content in its service; whereas Sky's maximum bid will depend on the incremental impact on its profitability of retaining this content.[10] If the outcome of the auction were not to influence the price charged by Sky or a rival bidder, then the

[7] Sometimes the studio may choose to negotiate with just one party or to negotiate with multiple parties (either sequentially or in parallel).
[8] We noted that the relevance of factors such as these was likely to vary between studios. [✄]
[9] Because, in our view, most rival bids for a studio's FSPTW rights would be likely to have a broadly similar impact on other forms of distribution compared with Sky's (achieved through holdbacks and exhibition restrictions).
[10] In a context in which Sky is likely to hold the FSPTW rights of the five other major studios.

rival's bid will be determined by how many new customers it expects to attract (at its existing prices) as a result of being able to offer this content. By contrast, Sky's bid will be determined by how many existing customers it expects to lose (at its existing prices) as a result of not retaining the content. If the outcome of the auction were to influence pricing, then the incremental revenue from raising price (or not reducing price) would also be factored into the assessment.

7.19 In a hypothetical scenario in which there was only one set of FSPTW content rights, and the long-term profitability of a subscriber was the same for both Sky and its rival, the rival could outbid Sky if it expected to acquire more subscribers on the basis of the content than Sky expected to retain. However, in practice, there are six sets of FSPTW rights from the major studios. If these rights are complements to one another (see paragraphs 7.84 to 7.96), they are likely to be more valuable to the incumbent (in this case Sky); though, if this complementarity is exhausted before the content from all six studios is aggregated, then, leaving aside strategic considerations, the rival may value the rights of the sixth (and possibly the fifth and the fourth) studio more highly than the incumbent.

Evidence from negotiations for major studio FSPTW rights

7.20 We asked the major movie studios and possible bidders for information about their negotiations for FSPTW rights.

7.21 In the eight years prior to our report, there were [✂] occasions when the FSPTW rights of a major studio came up for renewal and a deal was completed, by which we mean an agreement was signed (see Table 7.2). The most recent of these was in [✂]. Before this period, [✂].

7.22 This section contains a summary of all of the evidence we received in relation to: *(a)* the completed negotiations for FSPTW rights which have taken place in the last eight years; and *(b)* recent discussions [✂].

TABLE 7.2 **Completed and recent negotiations for FSPTW rights of major studios**

Movie studio	*Date of contract start*	*Participating companies*
[✂]	[✂]	[✂]
[✂]	[✂]	[✂]
[✂]	[✂]	[✂]
[✂]	[✂]	[✂]
[✂]	[✂]	[✂]
[✂]	[✂]	[✂]
[✂]	[✂]	[✂]
[✂]	[✂]	[✂]
[✂]	[✂]	[✂]
[✂]	[✂]	[✂]
[✂]	[✂]	[✂]

Source: Major studios, prospective bidders and Sky.

[✂]

Completed negotiations

7.23 Focusing on the [✂] completed negotiations, there were [✂] occasions when rivals to Sky had [✂] to acquire a major studio's FSPTW rights. However, on no occasion had any of these rivals been successful in outbidding Sky for a major studio's FSPTW rights. These [✂] occasions were: [✂].

7.24 [✂]

7.25 [✂]

7.26 [✂]

Recent negotiations

7.27 We noted that, [✂]. At the time of our report, [✂].[11]

7.28 We noted that Netflix had made a number of public statements about its interest in acquiring FSPTW content from a major studio for its UK service: [✂].[12]

7.29 [✂]

7.30 [✂]

7.31 [✂]

7.32 [✂][13,14,15,16,17]

7.33 [✂][18,19]

7.34 [✂][20]

7.35 In relation to [✂], we noted that: [✂].

7.36 [✂]

Evidence from LOVEFiLM and Netflix's engagement with non-major studios over FSPTW rights

7.37 We noted that, in relation to the non-major studios, LOVEFiLM had signed exclusive FSPTW output agreements with eOne and Studiocanal. We noted that Netflix had done the same with Lionsgate (which now also distributes the content of Icon), MGM and Momentum.[21,22] In at least one case, [✂].[23,24]

7.38 A couple of parties told us that, in the next couple of years after the date of our report, MGM, which is a large non-major studio, is going to be the pay-TV distributor in the UK of some popular content (in particular, the *Hobbit* movies). [✂]

Analysis of barriers to the acquisition of major studio FSPTW content

7.39 In this subsection, we set out our assessment of whether there are barriers to pay-TV rivals acquiring FSPTW rights from the major studios in competition with Sky.

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[11] [✂]
[12] [✂]
[13] [✂]
[14] [✂]
[15] [✂]
[16] [✂]
[17] [✂]
[18] [✂]
[19] [✂]
[20] [✂]
[21] [✂]
[22] Netflix told us that it believed that the cost of these three agreements would be [✂].
[23] [✂]
[24] Sky also told us that [✂].

7.40 Accordingly, in this section we:

(a) assess the bidding activity of both traditional and OTT pay-TV retailers to determine what this can tell us about barriers to obtaining FSPTW rights;

(b) summarize our assessment as to the barriers facing traditional pay-TV retailers or aggregators wishing to distribute via traditional pay-TV retailers;

(c) summarize our views on whether FSPTW content of the major studios is complementary in nature (and consider the possible implications if it is complementary), and discuss bidders' strategic incentives when they are bidding for such content; and

(d) assess the barriers facing OTT pay-TV rivals.

7.41 Our analysis in this report of the risks faced in the past by a traditional pay-TV retailer seeking to bid against Sky for the FSPTW rights of the major studios is largely unchanged from our August 2011 provisional findings. However, in light of our views with respect to the position of OTT pay-TV retailers (see paragraphs 7.176 and 7.177), and given that, for the purposes of this assessment, we were not concerned with the prospects of a specific type of pay-TV retailer, we did not consider it necessary to reach a definitive view as to whether traditional pay-TV retailers would continue to face the same barriers in the future (see paragraph 7.8).

Assessment of bidding activity

7.42 In relation to the bidding of the traditional pay-TV rivals in completed negotiations (see paragraphs 7.23 to 7.26), it appeared to us that:

(a) The evidence for the period prior to [✂] was consistent with there having been barriers to the acquisition of rights. [✂], it appeared that no rival was able to make a more attractive bid for a major studio's FSPTW rights than Sky, [✂].

(b) [✂] because of: (i) the impact of our investigation;[25] (ii) the existence of obstacles to contesting or monetizing the rights which discouraged rivals from making the necessary investment; or (iii) a decline in the significance of products with FSPTW content to competition between traditional pay-TV retailers (see Section 6).

7.43 [✂]

7.44 [✂]

7.45 [✂][26]

7.46 Sky told us that Netflix and LOVEFiLM were credible, capable challengers to Sky for movie rights and noted that: *(a)* both had acquired FSPTW movie rights from a variety of studios [✂]; *(b)* Netflix had stated publicly its intention to compete against Sky for FSPTW movie rights from major studios; and *(c)* both Netflix and LOVEFiLM had been successful in securing FSPTW rights from major studios in other territories.

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[25] Sky told us that Neil Berkett, Virgin Media's CEO, commented to analysts in August 2009 in a Q2 Earning Release Conference Call, 'Given our recent success, our decision to focus our attention and resources on the regulatory debate rather than competing head on and acquiring premium content is proving to be the right one'.
[26] [✂]

7.47 [✂][27]

7.48 We also noted that Netflix had made public statements over the course of our inquiry, first of all stating that regulatory intervention was not required because it did not face material barriers preventing it from acquiring FSPTW rights from the major studios, but more recently stating that, while it intended to continue to compete vigorously against Sky for FSPTW content, it was strongly of the view that we should not jump to conclusions about the impact of LOVEFiLM and itself on competition. Netflix stated that, if it proved to be unable to acquire FSPTW content from major studios in the next year or so, it may support a case for market intervention. BT noted that Netflix's original comments were made when Netflix had very little if any experience of operating in the UK (and substantially less experience than LOVEFiLM) and that its views were subsequently refined when it had more experience of the UK market. While we acknowledged BT's point, it appeared to us that Netflix had, at the time of its earlier comments, considerable experience in bidding for FSPTW rights in other territories and we could not rule out that its change of position may have been influenced by our inquiry. [✂]

7.49 We assessed the bidding activity of LOVEFiLM and Netflix in relation to the FSPTW rights of non-major studios to see whether this might be informative about their interest and prospects of success in acquiring FSPTW rights of the major studios (see Appendix 7.3). Virgin Media told us that Sky had shown considerably less appetite for the output of non-major studios than for the output of the major studios and, as such, it was to be expected that the barriers to the acquisition of the FSPTW rights of these studios were lower (either because Sky may not have bid for them or because, even if Sky did bid, its lower valuation made it more feasible for others to win). Virgin Media said that Sky was likely to have a lower valuation for this content because Sky already had access to sufficient content to create a very attractive movie service and because acquiring these rights did not provide the strategic benefit to Sky of foreclosing rival competitors.

7.50 BT said that, with regard to the exclusive FSPTW rights of the non-major studios, Sky had sometimes not bid as much as entrants for this content because it had already aggregated all the FSPTW rights from the major studios (and the FSPTW rights from some of the non-major studios). With this content Sky knew that it could offer the most compelling movie service and that the de minimis share of UK box office represented by a small number of movies from some of the non-major studios would not enable entrants to compete effectively with its movie services. We took from this submission that BT believed that, as a result of Sky's reduced need and hence lower demand for the FSPTW output of some non-major studios, under certain circumstances Sky might choose not to outbid an entrant for these rights.

7.51 We agreed with Virgin Media and BT that Sky was likely to place a lower value on content from non-major studios for so long as it continued to have access to sufficient content to assemble an attractive movie service (see paragraphs 7.107 to 7.117), and hence it could be easier for a rival to outbid Sky for this content. However, it appeared to us that this argument could also apply to content from a sixth major studio, in so far as Sky already had access to content from five other studios when bidding for content from the sixth major studio (see the discussion on complementarities in paragraphs 7.84 to 7.96).

[27] [✂]

7.52 We acknowledged that we could not be certain of the commercial incentives of any OTT pay-TV retailer to participate in any given auction process and ultimately to make the necessary investment to win. [✄][28]

Barriers faced by traditional pay-TV rivals (or aggregators wishing to distribute via traditional pay-TV rivals).

7.53 In this subsection, we summarize our analysis and reasoning in relation to barriers faced by traditional pay-TV retailers to the acquisition of major studio FSPTW content. This analysis has not changed materially since that set out in our August 2011 provisional findings, which was presented again in our May 2012 revised provisional findings, where we provisionally concluded that traditional pay-TV retailers had historically faced barriers to outbidding Sky for FSPTW rights.[29] Our analysis is set out in more detail in Appendix 7.5.

7.54 In its Pay TV Statement,[30] Ofcom found that there were important barriers to the acquisition of FSPTW rights which would remain in place in the absence of further regulatory intervention. Ofcom cited:

(a) the fact that, over a period of almost 20 years, Sky had always held the FSPTW rights of all the six major studios; and

(b) evidence from rival bidders' internal documents, which it said demonstrated that they were not in a position to outbid Sky.[31]

7.55 Given Sky's history of success in bidding for the FSPTW rights of the major studios, Ofcom did not believe that it was necessary for it to conclude on the reasons behind Sky's strong bidding position. Nevertheless, Ofcom did identify a number of factors which it said contributed to Sky's advantage over rival bidders. These were:[32]

(a) the delay that a new entrant would face in building a subscriber base as a result of consumer inertia/loyalty to Sky, hesitation by some customers and lower awareness of a new entrant, which reduced the value of the rights to a new entrant and hence the entrant's ability to bid for the rights;

(b) the efficiency advantages which flowed from bidders such as Sky being vertically integrated with a pay-TV retailer with a significant subscriber base, which provided, for example, greater certainty about wholesale income;

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[28] [✄]

[29] We noted in our August 2011 provisional findings that acquiring rights was not the only thing that a company would need to do to create a linear channel/SVOD service but that we could see no obvious reason why rival bidders would find it difficult to acquire the skills necessary to undertake these activities, and we noted that many potential rivals had some experience of doing these activities already. However, we noted that some rival bidders might still have faced difficulties distributing and marketing its channels as effectively as Sky because of Sky's position in the pay-TV retail market (see Appendix 7.4).

[30] In considering such barriers, Ofcom's view was that the appropriate thought experiment was whether new entrant(s) could acquire the majority of the FSPTW rights that Sky currently held, since, in its view, this was the content which would be necessary to undermine Sky's position. Whilst Ofcom noted that it was difficult to be precise about what was meant by 'majority' in this context (particularly because the importance of a major studio's movie rights would vary from year to year), it said that it would certainly regard Sky as having lost the majority if it lost 50 per cent of the rights, measured by the major studios' box office receipts in a particular year, and that this was likely to require the loss of two to four major studios' rights, depending on the identity of the major studios in question and what other movie rights were acquired (see Ofcom's Pay TV Statement, section 6, paragraph 6.308).

[31] Ofcom referred specifically to documents relating to [✄] by [✄] to acquire FSPTW movie rights. Ofcom said that [✄] (see Ofcom's Pay TV Statement, section 6, paragraphs 6.311 & 6.312).

[32] Ofcom's views on the first three of these factors are set out in Ofcom's Pay TV Statement, Appendix 8 to Annex 4. Ofcom's views on the impact of the staggered expiry of Sky's contracts are set out in Ofcom's Pay TV Statement, Appendix 4 to Annex 5.

(c) a range of bidder-specific factors, including access to funding and how the bidder positioned its business; and

(d) the impact of the staggered expiry of Sky's contracts with the six major studios.

7.56 Virgin Media said that it had proved impossible, on a commercially viable basis, to acquire FSPTW rights from any of the six major studios, because: *(a)* there was a limited pool of premium content; *(b)* Sky had exclusive agreements with these studios for both linear and SVOD rights; *(c)* contracts were long in duration; *(d)* expiration dates were staggered and *(e)* Sky, with its 10 million subscribers, was able to monetize its investment in premium movie rights more quickly and more efficiently than anyone else, which meant that, in order to monetize the rights, a rival bidder would need to negotiate either a wholesale supply arrangement or retail the content to Sky's customers directly, both of which, it said, would be fraught with difficulties. BT made similar points.[33]

7.57 [✂]

7.58 Disney told us that Ofcom's assessment of the barriers to entry overstated the significance of Sky's advantages when bidding for movie rights. Disney said that wholesalers prepared to make a sufficient investment in the provision of pay-TV movies would be able to compete successfully by aggregating a small volume of movie rights with high-quality TV programming to create an attractive offering. It said that, as a result of the staggered expiry of Sky's contracts with the movie studios, the studios' rights would become available on a regular basis every few years. Therefore, a new entrant with a mixed content offering could purchase additional movie rights over time and gradually change its programming mix as more studio rights became available and its subscriber base grew. Disney also told us that market entry and/or expansion was perfectly feasible for Sky's competitors, all of which were large companies with significant resources and the technical ability to provide a viable rival pay-TV movies offering (whether a pure movies channel or a mixed channel comprising movies and other high-quality TV content). [✂]

7.59 Fox told us that entry into the wholesale market was feasible without regulatory intervention into how rights were licensed. Fox also said that it would consider all commercially reasonable offers for its rights. Fox submitted that, with six competing major studios and a range of other content producers, there were plenty of rights available from a variety of sellers, which an entrant could buy to produce an attractive pay-TV product. [✂]

7.60 Sky told us that it was evident that, as a well-established incumbent, it had significant advantages in competing for pay-TV movie rights when they came up for renewal. Sky added that it was aware that other operators had either considered acquiring or had actively attempted to acquire FSPTW rights and had not been successful over a long period of time. However, Sky said that this did not mean that, to determined and

[33] Other parties made similar points. TUTV told us that, given the massive disparity between the size of Sky's subscriber base and those of its competitors, the studios knew that it would be very difficult for Sky's competitors to offer similar payments to Sky since, in the short to medium term at least, they did not have the subscriber numbers to justify them. Channel 4, which used to be a pay-TV retailer, told us that any potential new entrant desiring to build a comprehensive, competitive movie offer (whether linear or SVOD) would find it difficult to do so, given the staggered termination dates of the current licence agreements for FSPTW movie rights from each of the six major studios, and the duration of these contracts. Prior to our August 2011 provisional findings, one non-major studio told us that there were significant barriers to setting up a competing pay-TV service. The non-major studio highlighted, in particular, the considerable expense required to obtain enough content of sufficient quality to attract a critical mass of subscribers. This non-major studio said that, in the absence of content, the entrant's subscriber base and the growth of its new service would be limited, and it would never be able to compete effectively with Sky's movie products. The studio said that the staggered availability of Sky's contracts for FSPTW content helped Sky to maintain its position because there was no one moment when a critical mass of studios could walk away from Sky together.

committed operators, there were immutable or insurmountable barriers to entry and/or expansion such that Sky could ignore the prospect of being outbid for movie rights when contracts came up for renewal.

7.61 Sky cited five factors which it believed facilitated entry into and/or expansion in the production of premium movie channels. Sky said that:

(a) challenging for rights was easy because: (i) rights came up for renewal regularly; (ii) the costs associated with participation in tenders/negotiations were small; (iii) rights were awarded some time in advance of contract commencement, giving potential acquirers time to acquire any additional inputs necessary if they were successful; and (iv) the costs of developing pay-TV channels were modest, particularly for existing TV broadcasters;[34]

(b) there was a wide range of potential entry strategies including gradual entry over time (ie winning rights periodically and building up the channel offering, along with the subscriber base), which was a common model in the pay-TV sector,[35] and there was no reason to believe that a movie offering need be as broad as that of Sky Movies to establish a new entrant in the market;

(c) there was a wide range of potential entrants including: (i) existing TV broadcasters, of which there was a large range both in the UK and internationally, many of which already broadcast movies on their channels; and (ii) rights owners, most of which were already active in the TV sector internationally, as a result of which it would be a relatively small step to set up their own TV channels which broadcast their movies alongside library content and possibly some non-movie content,[36] or alternatively to enter into a joint venture with another rights holder(s);[37]

(d) the DTH platform was open, which meant that any entrant had the option to retail its channel directly to an addressable customer base of over 10 million households, assuring the entrant of being able to reach a sizeable proportion of the population and giving the entrant a strong bargaining position in the event that it wished to negotiate a wholesale deal with Sky or indeed any other retailer on Sky's DTH platform; and

(e) there were low switching costs for customers, which meant that, if rights moved between different broadcasters, it was straightforward for consumers to follow the content.[38]

7.62 However, we found that the principal challenge facing a rival bidder for the FSPTW rights of the major studios was gaining sufficient subscribers to warrant the neces-

[34] Sky told us that its payments to the six major studios (in relation to all movies licensed) in 2009/10 totalled £[✂] million. It said that this was not a significant amount in the context of the amounts spent by TV broadcasters on programming. It noted, for example, that, in 2009, ITV spent £[✂] million on programming for its digital channels (ITV2, ITV3, ITV4 and CITV) and, in the same period, Channel 4 spent £[✂] million on its digital channels (E4, More 4, FilmFour).
[35] Sky said that to expect entrants to make profits from day 1 of a new business was entirely unrealistic but that there was no obvious reason why entrants should bear significant losses as, whilst the wholesale revenue which could be earned from a new channel with limited content was likely to be small, the costs would be similarly small.
[36] Sky submitted that the ability of rights owners to move downstream was evident from the range of retail services already operated by the six major studios in the UK: FilmFlex (Sony and Disney), PictureBox (Universal), Warner Films (Warner) and TCM (Time Warner).
[37] Sky cited several examples where this had occurred, for example: *(a)* Sony and Disney, which operated the FilmFlex VOD service; *(b)* Hulu, an online video service, which was a joint venture whose owners included NBC Universal, News Corporation (owner of Fox) and Disney; and *(c)* United International Pictures (UIP), which was a distribution company jointly owned by Universal and Paramount.
[38] Sky said that any new entrant was likely to seek to distribute its content widely, which would mean that consumers would be able to subscribe to the new entrant's channel without switching platforms, and switching costs would be low.

sary investment. Accordingly, we considered how a rival might reach potential customers and we identified four ways in which a traditional pay-TV retailer (or an aggregator[39]) could distribute a movie product, two of which did not involve selling on Sky's platform and two of which did, as follows:

Distribution strategies not using Sky's platform

(a) Distribute the content via the platforms of one or more existing non-Sky pay-TV retailer(s), ie traditional pay-TV retailers like Virgin Media or BT. If the bidder was a movie studio, or an independent broadcaster, this might involve reaching a carriage agreement(s) with one or more traditional pay-TV retailer(s). If the bidder was already a traditional pay-TV retailer, it could sell its new or augmented movie product on its own platform and consider supplying its product to other traditional pay-TV retailers.

(b) Set up as a new traditional pay-TV retailer to distribute the content, seeking to attract consumers directly to a new platform/service (possibly in combination with strategy *(a)*).

Distribution strategies using Sky's platform

(c) In relation to linear channels only, retail via Sky's open DTH platform (possibly in combination with strategies *(a)* and/or *(b)*).[40]

(d) Wholesale to Sky (possibly in combination with strategies *(a)* and/or *(b)*).

7.63 In considering these four distribution strategies, we distinguished between linear and SVOD services as necessary. We found that it was generally the case that, where FSPTW content was available on a linear basis, the same content was only available in the same window on an SVOD basis on the same service.[41] In relation to SVOD services, it was also generally the case that FSPTW rights had been granted exclusively [✂]. Several parties told us that linear and SVOD services were close substitutes and that licensing linear and SVOD rights to the same movie in the same window would constitute non-exclusivity. We noted that [✂].

7.64 Therefore, in our view, in order for a rival bid to be successful, either:

(a) one bidder seeking to acquire linear and/or SVOD rights exclusively would have to outbid Sky for a package of linear/SVOD rights; or

(b) one or more bidders seeking to acquire linear and/or SVOD rights non-exclusively would have to offer a sum sufficient to induce the studio to license non-exclusively with Sky (or, in the event that Sky were to place little value on non-exclusive rights, the bidder(s) would have to compensate the studio for the loss of Sky as a licensee altogether (ie in effect match Sky's exclusive offer)).

Distribution strategies not using Sky's platform

7.65 A traditional pay-TV retailer/content aggregator could exhibit the major studio FSPTW content it obtained on a new or augmented linear channel(s) or SVOD ser-

[39] Including, possibly, a movie studio.
[40] A potential rival could not offer an SVOD product via Regulated Conditional Access since this only provides for linear channels to be broadcast over Sky's DTH platform.
[41] A channel broadcaster may wish to offer catch-up services alongside its linear broadcasts or a distributor of an SVOD service may wish to offer a linear channel.

vice, or a combination of the two.[42] This service could be distributed to consumers via one or more of the existing non-Sky traditional pay-TV retailer(s) (strategy *(a)* in paragraph 7.62), or by setting up a new traditional pay-TV retailing service (strategy *(b)* in paragraph 7.62), possibly in combination with strategy *(a)*. Our detailed discussion in relation to these options is set out in Appendix 7.5, paragraphs 7 to 18.

7.66 We observed that it was likely that a rival bidder to Sky which sought to offer a movie service without retailing or wholesaling via Sky would have to overcome the disadvantage of initially having far fewer movie subscribers than Sky[43] over which to recoup the cost of the rights. In other words, the incremental value a rival bidder could generate from the subscriber base it could achieve if it relied solely on migrating subscribers from Sky Movies (in the case of the Virgin Media and TalkTalk platforms), and/or if it relied solely on generating incremental value from existing movies service subscribers (in the case of Vision Film or PictureBox), would be likely to be smaller than the incremental value Sky would retain from continuing to offer content from all six major movie studios. We considered the following strategies which could be used to overcome this disadvantage:

(a) Encouraging pay-TV subscribers who were not subscribing to a movie service on the platforms on which the new service would be distributed to take up the channel/service; and/or

(b) encouraging pay-TV subscribers to pay-TV platforms on which the service was not distributed to switch; and/or

(c) generating new consumption from customers who were not currently pay-TV subscribers; and/or

(d) seeking to extract a higher margin on the service than Sky was able to, or on products which were sold alongside the movies service.

7.67 However, in light of our assessment of these strategies and the evidence provided by the parties, we determined that there would be significant uncertainty and risk associated with all of them, as follows:

- In relation to *(a)* in paragraph 7.66, we noted that the total number of pay-TV subscribers across all the non-Sky traditional pay-TV platforms [✂] the number of subscribers to Sky Movies [✂] so, even if a rival bidder could persuade a high proportion of subscribers on these other platforms to take up the service as a result of offering this content, it would be likely still to struggle to outbid Sky.

- In relation to *(b)* and *(c)* in paragraph 7.66, given the disparity between the number of existing subscribers to Sky Movies on Sky (some of whom might drop Sky Movies if the content proposition became worse) and the number of movie subscribers on the platforms of the other traditional pay-TV retailers, a rival bidder would need to access many more subscribers in order to close the gap.[44]

[42] We noted that [✂].
[43] As shown in Table 6.1, in May 2012 Sky had [✂] Sky Movies subscribers (representing [✂] per cent of its UK subscribers) and Virgin Media had [✂] Sky Movies subscribers (representing [✂] per cent of its UK subscribers). There were also [✂] of Sky by Wire subscribers to Sky Movies on the TalkTalk platform. There were about [✂] subscribers to BT's Vision Film (though [✂] paid an incremental price for Vision Film; [✂] took Vision Film as part of a pack which included other pay-TV content, for example BT Vision's current 'unlimited' pack includes other TV content and the ESPN sports channel as well as Vision Film).
[44] Our analysis of competition in the pay-TV retail market (see Section 5) found that there were low levels of switching between traditional pay-TV retailers, and from non-pay TV to traditional pay TV, which would make this even harder. One further factor which would limit a rival's ability to build a subscriber base was that some pay-TV customers are subject to a contract with their existing provider which would not permit termination without a penalty for a period of up to 12 months. In addition, we noted that

- In relation to *(d)* in paragraph 7.66, BT and Virgin Media told us that the broadband and telephony markets were very competitive and effectively regulated, and, accordingly, they could not earn high margins on such products to justify high bids for pay-TV content. Virgin Media also observed that taking such a step would reduce investment and innovation in those markets.

7.68 Having considered all the evidence and the further submissions made by the parties, we found that it was precisely the factors which prevented competition from being effective at the retail level (ie Sky's large, incumbent position, the low level of switching between suppliers and the difficulty of large-scale entry and expansion (see Section 5)) which had enabled Sky historically to exploit FSPTW rights more effectively than its traditional pay-TV rivals. In our view, the only way in which traditional pay-TV rivals/content aggregators could circumvent these disadvantages to create a movies service which could compete effectively with Sky Movies was to gain access to Sky's subscriber base, either via securing a carriage agreement with Sky or by self-retailing on the basis of Regulated Conditional Access (and we noted that the latter would only be an option for distributing a linear movies channel).

Distribution strategies using Sky's platform

7.69 A rival with FSPTW content could distribute the linear element of its offer by self-retailing on Sky's platform or it could wholesale its service (linear, SVOD or both) to Sky (strategies *(c)* and *(d)* respectively in paragraph 7.62). In this subsection, we summarize briefly our findings in respect of each of these strategies. Our detailed discussion in relation to these strategies is set out in Appendix 7.5.

- *Self-retailing on Sky's DTH platform*

7.70 We observed that:

(a) The strategy of self-retailing on Sky's platform did not appear to be a very effective way of exploiting movies content even though retailers could obtain conditional access to it. This was because the self-retailer would lack the bundling advantages enjoyed by Sky, and therefore the movie channel provider would not obtain any of the pricing and marketing benefits associated with bundling. As a result, the retailer would be likely to have to incur high marketing and selling costs to reach Sky's subscribers.

(b) There was relatively little self-retail activity on Sky's DTH platform, and those third parties which did retail via Sky's platform had [✄] subscriber numbers (see also Appendix 5.2).

7.71 Having considered all the evidence and the further submissions made by the parties,[45] we found that:

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Virgin Media's services were only available to approximately 50 per cent of UK households. Moreover, we noted that, in relation to linear channels, BT had been relying on capacity-constrained DTT to distribute linear channels to its subscribers, which had limited the number of channels it had been able to offer.

[45] Sky told us that, in practice, in order to maximize its prospects of success, a linear pay-TV channel with FSPTW movie content would probably seek to be retailed by Sky. Sky said that entering into a wholesale arrangement (ie securing a carriage agreement with Sky) was likely to be the more attractive option to a rival bidder for FSPTW rights because, although self-retail was straightforward, most broadcasters generally had no inclination to become pay-TV retailers and lacked the necessary skills and experience to do so.

(a) It was unlikely that a traditional pay-TV retailer (or aggregator) would seek to distribute its movie channel by self-retailing on Sky's platform because it would not provide an effective way of attracting a large number of subscribers.

(b) It was more likely that the rival pay-TV retailer would seek to access Sky's subscriber base by agreeing a carriage agreement with Sky (ie wholesaling to Sky).

- *Wholesaling to Sky*

7.72 We noted that, at the time of bidding, it was unlikely that a rival bidder for FSPTW rights would have been able to secure a carriage agreement with Sky because:

(a) Without knowing what movie content the rival was going to be able to obtain, the nature of the movie channel to be carried would be very uncertain, so agreeing terms of carriage would be difficult.

(b) We could see no reason why Sky would wish to give its rival bidder this certainty of carriage.

(c) BT and Virgin Media both told us that seeking to secure a carriage agreement for a premium movies channel with Sky prior to bidding for FSPTW movie rights would be highly unattractive from a commercial perspective because, among other things, it would involve disclosing to Sky the nature and quantity of the rights for which it wished to bid, which could help Sky in its competing bidding strategy.

7.73 For these reasons, it appeared to us likely that, at the time of bidding, the rival bidder would not know whether or not it would be able to reach a commercially attractive wholesale arrangement with Sky. In contrast, Sky, with its large incumbent Sky Movies subscriber base, would know that if it retained FSPTW rights from all six studios, it could continue to offer its resulting movie service to a very large number of subscribers.

7.74 We considered evidence from Sky which said that:

(a) Sky had a strong incentive to offer its subscribers as wide a range of content as possible, including a rival's movie service. This was shown in particular by the fact that it retailed other movie channels (eg FilmFour).

(b) Whilst it was not possible to determine what the outcome of any specific commercial negotiation would be, Sky was confident that a reasonable commercial deal, which benefited both parties, could be done.

(c) If it lost some of its FSPTW rights to a rival, as a broadcaster Sky's main considerations would be: (i) how its saving in costs (not having to pay for rights) should be deployed; and (ii) how it should alter its Sky Movies services.

7.75 However, we observed that:

(a) Sky's evidence failed to take account of its vertical integration, ie that Sky's pay-TV retail and broadcasting businesses were two parts of the same company. We would have expected Sky's behaviour in deciding whether to sign a wholesale agreement to be influenced by both its position as a broadcaster *and* its desire to protect its position in the retail market.

(b) Although it was uncertain how subscribers would react to a new channel with FSPTW movie content and, accordingly, how Sky would respond if a broadcaster of such a new channel sought a carriage agreement with Sky, it appeared to us likely that Sky would have taken into account:

   (i) if Sky carried the rival channel, that this would reduce the number of subscribers to Sky Movies (who were also subscribers to Sky's platform) as some consumers would switch to the new channel (although this effect could be small if the channel was at an early stage of development or if it was viewed as complementary to Sky Movies); and

   (ii) if Sky did not carry the channel (or carried it on unfavourable terms), that other pay-TV retailers offering the channel would have a point of differentiation, which, among the other attributes of its service, could have enabled them to attract some subscribers that might otherwise have chosen or stayed with Sky.

(c) Sky might also have taken into account any strategic effects of carrying the rival's product, in relation both to its impact on the market for the acquisition of FSPTW rights (the upstream market) and if relevant to its position in the pay-TV retail market (the downstream market).

7.76 In relation to this last consideration, it seemed to us that, if Sky had agreed to carry a rival broadcaster's movie product in such circumstances (on terms acceptable to the rival), this would have been likely to:

(a) enhance the rival's expectations of demand for the product and increase the rival's willingness to bid for rights in the future, increasing competition in the upstream rights market; and

(b) assist in establishing an alternative movie product which was not branded or controlled by 'Sky', which at that time may have increased the ability of Sky's pay-TV rivals to compete with Sky in the downstream pay-TV retail market (though this would have depended on the significance of FSPTW movie products to competition in the pay-TV retailer market, which we discuss in section 6).[46]

7.77 It appeared to us that, for these two reasons, together with the risk of the new service cannibalizing subscriptions to Sky Movies on Sky's platform there was a significant possibility that, despite the risks to Sky of rival pay-TV retailers enhancing their offering on the basis of the rival channel, Sky might prefer not to offer such a channel (or only to offer it on the basis of carriage terms which were unfavourable to its rival) (see Appendix 7.5, paragraph 37).

- *Other considerations*

7.78 We also considered whether:

(a) Sky's decision to carry a rival's movie channel was likely to be influenced to some extent by the number of studios' FSPTW rights which the rival gained (and which Sky, by that time, would have lost);

(b) Sky's experiences in wholesaling other channels were informative;

[46] We found that there appeared to have been a decline in the significance of FSPTW movies to consumers' pay-TV subscription decisions (see paragraph 6.96).

(c) the internal documents of rival bidders for FSPTW rights were informative about their perceptions of whether Sky would carry their potential movie channel(s) and hence as to their likely bidding behaviour; and

(d) the challenges faced by a movie studio seeking to launch a movie service via a traditional pay-TV retailer in competition with Sky Movies would be different from those facing other new entrants.

7.79 We found that, in order to mitigate Sky's strategic incentives not to carry a rival's product, a rival could enter on a large scale. However, it would be: *(a)* difficult to predict the threshold above which the rival bidder could be confident that Sky would be incentivized to carry its product; *(b)* large-scale entry would have its own significant costs and risks; and *(c)* the risks might be greater by virtue of the staggered availability of rights. We noted that the latter issue would also give Sky time to respond by increasing its bids for other rights. For this reason, it appeared to us that, although entering on a large scale diminished the risks associated with reaching an attractive wholesale agreement with Sky, it would be significantly harder (and more risky) to achieve, in particular due to the increased possibility of a competitive response from Sky.[47]

7.80 On the basis of all the evidence (including [✂] and the internal documents of prospective bidders), we concluded that, even if a potential bidder for FSPTW movie rights could be confident of reaching some form of wholesale agreement with Sky, it could not be confident that this agreement would enable it to reach enough subscribers in order to outbid Sky. Furthermore, the process of negotiating carriage would depend to a great extent on Sky, and we noted that any rival bidder would face the prospect of being forced to delay the launch of its channel due to protracted negotiations with Sky, which in itself could be sufficient to undermine the value that the rival bidder would be willing to offer.

7.81 We considered whether the challenges faced by a movie studio seeking to launch a movie service via a traditional pay-TV retailer in competition with Sky Movies would have been different from those facing other new entrants and noted that none of the movie studios which had created pay-TV channels in the UK had sought to exploit their FSPTW rights through these channels [✂].

Conclusion on historical barriers relating to traditional pay-TV retailers

7.82 We found that, historically, there were significant problems associated with all the ways in which a traditional pay-TV retailer, or movie studio/content aggregator seeking to distribute via a traditional pay-TV retailer, might have sought to distribute a new movie service. We found that the key problem would have been gaining sufficient confidence of being able to reach enough subscribers with the new channel to be able to justify a bid greater than Sky's.

7.83 However, in light of our conclusions in relation to OTT pay-TV retailers (see paragraphs 7.176 and 7.177), we did not come to a view as to whether traditional pay-TV retailers would continue to face the same barriers in the future.

[47] We noted that for non-large-scale entry into the market the staggered availability of rights would not be as much of an issue because, in practice, rights came up for renewal in clusters (ie the gaps between opportunities arising to negotiate new licensing agreements with different major studios were not always large (see Tables 7.1 & 7.2)).

The role of complementarities

7.84 In response to our August 2011 provisional findings, Sky submitted a paper by Neven and Langus which contained modelling showing that, where FSPTW rights are complements to one another, a concentration of rights can arise naturally in the absence of any asymmetry in the downstream market. This implied that complementarities between FSPTW content from the major studios, if present, could generate a barrier to the acquisition of these rights (albeit one that would be expected to yield some customer benefits), because retaining a major studio's FSPTW rights would always be worth more to Sky who already holds FSPTW rights from the other major studios than to a new entrant.

7.85 Sky submitted that there were several pieces of evidence which indicated complementarity among FSPTW rights from a consumer perspective,[48] as follows:

(a) Where a consumer wished to watch a movie at the cinema or buy a DVD, he/she would choose among all the movies available and select by reference to their titles and other known characteristics, as all were potential substitutes. In contrast, where a consumer was deciding whether to subscribe to a dedicated movie channel(s), potentially with a view to maintaining his/her subscription for several years, he/she would not know precisely which movies would appear in the schedule and he/she would select the movie channel(s) according to the range of movies which the consumer expected it to offer. In this context, a larger choice would be more valuable.

(b) In practice, a channel/package was likely to offer a larger number of high-quality movies if it sourced movies from a larger number of studios, recognizing that studio market shares were volatile.

(c) Sky's own business plans confirmed that it considered that consumers valued a wide range of movies.

(d) TUTV in its evidence to the CC emphasized the importance of offering a range of recent movies.

(e) Virgin Media in its evidence to the CC suggested that, owing to volatility in individual studios' output, a channel needed access to the FSPTW content of no fewer than three major studios in order to assemble an appealing package.

7.86 However, it seemed to us that all these points demonstrated was that consumers value range (ie consumers will generally prefer a service which offers more content than one which offers less), and this could be the case whether a consumer considers additional content a partial complement or a partial substitute.

7.87 Although adding content to a service may increase a customer's valuation of it, in order to ascertain whether the content is complementary (in an economic sense) we needed to know whether such content increased a customer's valuation by more than the stand-alone value of that content. Intuitively, consumers who place significant value on the option to be able to watch any movie that has been released on the movie service they sign up to (motivated, for example, out of a preference to see all action movies or all romantic comedies) are more likely to consider movie content as complementary than consumers who are less wedded to being able to watch specific

[48] In other words, supporting the notion that the total of the individual values of subscribing to a single service offering access to FSPTW movie content from a large number of studios is higher than the total of the individual values of subscribing to a number of services each with some FSPTW movie content.

movies (and are therefore less concerned if some are not available on their movies service).

7.88 It appeared to us that what ultimately mattered from the point of view of assessing whether complementarities might represent a barrier to entry was whether FSPTW rights were considered complementary from the perspective of aggregators. If customers viewed FSPTW content from the major studios as complementary, it was likely that aggregators would too, but aggregators might in any case consider this content to be complementary even if consumers did not (in the strict economic sense as defined in the footnote to paragraph 7.85). This is because, where the valuations assigned to the content produced by different studios were negatively correlated (that is, some consumers valued the content produced by Studio A a great deal and Studio B less so, and others valued the content of Studio B a great deal and Studio A less so), the ability to aggregate this content might enable a service provider to even out willingness to pay and extract greater rents through the packaged offering (bundling content in this way is, in effect, a form of price discrimination).

7.89 We noted that, in principle, the impact of adding another tranche of FSPTW content to a service could well be different depending on how much content was already on the service, and that this pattern could be different for different types of service (eg a predominantly linear offering compared with a predominantly SVOD offering). This was relevant to our consideration of barriers because, if complementarities were to be exhausted before all six major studios were aggregated, the value to Sky of retaining its sixth studio could be less than the value to a new entrant of acquiring its first studio (abstracting from other factors, such as subscriber numbers and any willingness on Sky's part to bid higher to prevent competition from emerging).

7.90 In our view, it seemed unlikely that many customers would place significant value on the option to see all the movies released by the major studios in the FSPTW. Rather, it seemed to us that many customers subscribed to a movie service in order to have access to a sufficient range of content to provide them with a reasonable choice from which to select an attractive movie. We also noted that, in contrast to live sports and competitions such as the FAPL, movies could be watched in a variety of ways at different times. Therefore, even if a consumer wanted access to a specific movie, he/she could always watch it at the cinema, on DVD, via TVOD, or on another subscription service which offered it in the SSPTW or on FTA TV. For this reason, it appeared to us that it was unlikely that a significant number of customers would view FSPTW content from all six major studios as complementary (in a non-exhaustive way). Instead, it seemed likely that the degree of complementarity was likely to become exhausted as additional FSPTW content was added to a service and before the point at which all six studios' FSPTW content was aggregated.

7.91 We also noted that:

(a) [✂]

(b) [✂]

(c) Sky's internal documents provided some evidence that, in the past, [✂]. Whilst we noted that these assessments were made at a time when Sky licensed more FSPTW content from non-major studios (in addition to all six major studios), it suggested that, whilst the content of a sixth studio would add some value to Sky's service, it was unlikely that it would add more than the stand-alone value of the content.

7.92 To gain additional insights on this issue, we asked the major studios to tell us whether they had ever made licensing their content conditional on content from another major studio also being available on a service. We received the following responses:

(a) [✂]

(b) [✂]

(c) [✂] told us that its pay-TV licence agreements with Sky contained a provision which [✂].

(d) [✂] told us that FSPTW rights were not generally conditional on participation by other major studios but that, given the high risks and difficulty associated with predicting which services would succeed, it had an interest in ensuring that its content was not the sole content available on a new technology or service. [✂] said that this risk had been managed occasionally by requiring that the service had other major studio content.[49] [✂] also told us that although these provisions were included for its protection, they were not inviolable and had not prevented [✂] from being innovative. [✂] said that, [✂].

7.93 It appeared to us that this evidence could be interpreted to suggest that some of the major studios believed that the FSPTW content of more than one major studio was required on a service in order to maximize the value of the content overall. However, this interpretation was not entirely clear: first, it was not consistently the case ([✂] studios that had had such a provision in their agreements [✂]); and second, the behaviour of [✂] suggested that such studios may be primarily interested in ensuring that there is sufficient other content on the service, but would not necessarily require it to be major studio FSPTW content. This suggests, in so far as there are complementarities between movie studio output, these might be achieved in ways other than solely aggregating FSPTW content.

7.94 We also noted that in many other countries, for example the USA, FSPTW rights from the major studios were split across services, which we would not expect to occur if FSPTW rights were complementary.

7.95 Overall, it appeared to us that the evidence indicated that, although there were some complementarities between FSPTW content, these were likely to be exhausted at some level of content aggregation. For Sky, it seemed likely that complementarities between FSPTW content would be exhausted before all six major studios were aggregated, but at what exact point this occurred was unclear. For other types of movie service (eg the OTT services of LOVEFiLM or Netflix), it appeared that the point at which FSPTW content ceased to be complementary could be much lower (given that these services appeared to focus less on offering substantial volumes of FSPTW content). This implied that complementarity between the major studios' FSPTW content was unlikely to explain the level of content aggregation we had observed historically, and it did not appear to represent a barrier to the acquisition of at least one major studio's FSPTW rights (albeit complementarities could become more of a barrier when seeking to acquire further major studio FSPTW rights).

7.96 We noted that, if rival bidders already licensed some content which was itself complementary to the FSPTW content of a major studio (eg FSPTW content of a non-major studio, or SSPTW content), this would increase the value to them of the major

[49] For example, [✂].

studio's FSPTW content compared with its stand-alone value. We discuss this further when assessing the barriers facing OTT pay-TV retailers (see paragraphs 7.97 to 7.175).

Barriers relating to OTT pay-TV retailers

7.97 In this subsection, we set out our analysis of whether OTT pay-TV retailers face the same barriers to the acquisition of major studio FSPTW content as faced historically by traditional pay-TV retailers, namely the risk of being unable to reach enough subscribers with their movie service to justify a bid in excess of Sky's (see paragraph 7.82). Given that, at the time of our report, the principal OTT services offering movie content were those of Netflix and LOVEFiLM, we considered the prospects for acquiring major studio FSPTW content largely by reference to these two retailers (though we believed much of the reasoning would be applicable to another OTT pay-TV retailer if it offered a similar proposition in similar competitive conditions to Netflix and LOVEFiLM).[50]

7.98 Before setting out our detailed assessment of whether OTT pay-TV retailers face barriers to the acquisition of FSPTW rights from the major studios, we first of all provide a brief overview of the views of the parties.

Parties' views

7.99 Sky told us that the barriers to competing for FSPTW movie rights which we had identified in our August 2011 provisional findings did not apply to OTT pay-TV retailers. Sky said that, rather, OTT pay-TV retailers were well placed to compete against Sky for these rights. Sky said that OTT distributors benefited from a number of bidding advantages, including: *(a)* they provide their services directly to consumers via a wide range of devices at low price points; *(b)* they are well resourced and have global operations and pre-existing relationships with the studios (for example, in the sale or rental of DVDs, a window whose value to the studios is far greater than the FSPTW); and *(c)* they bundle movie services such as, in LOVEFiLM's case, DVD rentals, EST, TVOD and streamed SVOD movies, which assist them in the acquisition of attractive movie rights (including FSPTW rights). Sky also said that such advantages had enabled distributors like Netflix successfully to enter new markets and rapidly build scale. Sky said that the OTT services of Netflix and LOVEFiLM were part of a broader trend of a rapidly increasing quantity of audio-visual programming being delivered to consumers over the Internet. Sky said that the underlying market trends suggested that there would be further developments in this direction, making it likely that there would be further credible bidders for FSPTW (and other) movie rights in the foreseeable future.

7.100 Sony Pictures told us that developments in the market demonstrated that the barriers to acquiring FSPTW rights which we had identified in our August 2011 provisional findings were not significant. It said that Internet-connected TVs and other devices (which enabled consumers to watch movies distributed over the Internet) meant that a very large proportion of the UK population (exceeding Sky's subscriber base) would, within the foreseeable future, have access to OTT services. Sony Pictures also noted our finding (in our August 2011 provisional findings and restated in our revised provisional findings) that many of these new consumers would not have to incur any significant cost in order to access these services.

[50] In particular, in so far as it was able to offer a similar amount of non-major FSPTW content and major/non-major SSPTW, TSPTW and library content as Netflix and LOVEFiLM were each able to offer at the time of our report.

7.101 Disney expressed the view that OTT distributors did not face material barriers to the acquisition of FSPTW rights because their services could be perceived either as an alternative or as a complement to a traditional pay-TV subscription, and could be accessed directly by consumers via a range of devices using existing broadband infrastructure. Disney said that Sky's large subscriber base and costs associated with switching pay-TV retailers did not therefore impair the acquisition of subscribers by OTT SVOD services. Disney told us that the developments which had occurred in the market were inconsistent with the existence of barriers to the acquisition of FSPTW content.

7.102 Paramount, Warner and Universal all expressed similar views to the effect that OTT pay-TV retailers did not face material barriers to the acquisition of the FSPTW rights of major studios because these retailers were able to retail their services directly to consumers and therefore had the ability, potentially, to generate a large subscriber base very rapidly.

7.103 On the other hand, BT told us that the use by OTT operators of the Internet to reach customers in no way ameliorated the barriers to entry which we identified in our August 2011 provisional findings. BT said that those findings showed clearly that Sky's overwhelming bidding advantages stemmed from its existing retail subscriber base and, in particular, its substantial number of subscribers who were willing to pay for a premium movies service. BT said that a rival bidder, irrespective of whether its means of distribution was cable, satellite, DTT, IPTV or OTT, would still need to recruit and retain a sufficient number of premium movies subscribers in order to monetize any major studio FSPTW movie rights it might acquire. BT said that, in this respect, OTT providers were no different from other pay-TV retailers, such as BT Vision. BT said that material subscriber growth for a new or existing movies service was contingent upon access to the most attractive content, and this access was not possible while the content remained monopolized by Sky.

7.104 Virgin Media told us that the development of new technology and services would not itself result in an increased choice of services, and therefore competition, in circumstances in which access to key content was restricted. Virgin Media said that market commentators, although noting a potential doubling in the proportion of households able to access OTT services, had identified other barriers which would inhibit take-up (in particular, a resistance to pay-TV services and the existence of free alternatives).

7.105 Prior to our August 2011 provisional findings, we also spoke to Google, Apple and Microsoft about their future VOD plans. Some of these parties acknowledged that they had the financial resources to bid competitively against Sky for FSPTW movie rights in the UK but said that, either because of the size and value of Sky's satellite subscriber base, or because Sky was best placed to gain value from both the linear and SVOD rights which were currently sold together, Sky would be able to generate more revenue from these rights and so would be prepared to bid more. Google told us that the amount it would be willing to bid would depend largely on the value of this content to its online audience. However, we observed that none of these three parties were focused on offering SVOD movie services and appeared to us to remain focused, both in the UK and in other geographic markets, on offering TVOD/EST services.

7.106 Ofcom told us that it did not see any evidence presented in our working paper on market developments (working paper 29) to suggest that Sky's bidding advantages had diminished.

7.107 Prior to our August 2011 provisional findings, LOVEFiLM told us that it had been unable to obtain key digital movie rights. [✂]

7.108 Subsequent to our August 2011 provisional findings, LOVEFiLM told us that, [✄].

7.109 We observed that Netflix had in the past made public statements that it expected to compete head to head with Sky for the FSPTW rights of major studios, and that regulatory intervention was not required.[51] These statements suggested that Netflix did not believe itself to face material barriers to the acquisition of these rights. However, subsequently, Netflix stated publicly that if it was unable to secure rights to FSPTW content from major studios in the next year or so, it may support a case for market intervention (see paragraph 7.48).[52] Netflix said that, due to economies of scale, Sky had the ability to spread the costs of Sky Movies across more subscribers and bundle Sky Movies with other premium offerings (eg Sky Sports), thereby reinforcing the stability of Sky's subscriber base. Netflix also said that many major studios negotiated with Sky in multiple ways (eg for carriage of channels, licensing of TV shows, etc) and that Sky had the ability to combine these negotiations with its negotiations for FSPTW rights, allowing Sky to acquire FSPTW rights from some studios even if a rival were to submit a higher bid solely for the FSPTW rights. Netflix said that, while it intended to continue to compete vigorously against Sky for FSPTW content, it was strongly of the view that we should not jump to conclusions about the impact of Netflix and LOVEFiLM on competition for FSPTW rights.

Access to sufficient consumers to monetize a bid

7.110 We considered whether an OTT pay-TV retailer, such as LOVEFiLM or Netflix, was likely to face the same level of difficulty in attracting subscribers to its movie service as a traditional pay-TV retailer (see paragraph 7.82).

7.111 We noted that the movie content on the OTT services of LOVEFiLM and Netflix was typically available to consumers at a lower price than premium movie content was available via the traditional pay-TV retailers (see paragraph 6.119*(a)*). We also noted that consumers did not need to subscribe to the OTT services of LOVEFiLM and Netflix on top of a basic subscription package, ie there was no 'buy through requirement'.[53] In our view, this meant that OTT pay-TV retailers were better placed than traditional pay-TV retailers to attract price-sensitive customers who were not currently subscribing to pay TV. Moreover, OTT services were also likely to be better placed to attract customers who currently subscribed to a traditional pay-TV service. This was because a traditional pay-TV retailer would need to persuade a subscriber to switch his/her entire pay-TV subscription which could involve incurring the inconvenience of *(a)* switching any associated broadband or telephony services; *(b)* installing new infrastructure (eg a dish or cable); *(c)* receiving delivery of new hardware (eg a dedicated STB); and *(d)* entering into a long-term contractual commitment. By contrast, customers of an OTT service offered on a stand-alone basis[54] could take it on top of their existing traditional pay-TV package, or in place of part of it (eg Sky Movies), would not require the installation of any new infrastructure or the purchase of new hardware and would not require any long-term contractual commitment.

7.112 We noted that:

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[51] Letter to Netflix shareholders from its CEO and CFO, 25 January 2012.

[52] Netflix told us that, in the event that Sky's market power prevented it from competing effectively head to head for rights which Sky wanted, it would be restricted to obtaining content via other routes, eg SSPTW and TSPTW rights for movies where Sky's focus was on the FSPTW rights or FSPTW rights from studios which were not Sky's focus.

[53] BT offers Vision Film separately from other pay-TV services. However, we noted that BT did not appear to market this option [✄] and [✄] per cent of BT Vision's customers subscribed on this basis. BT told us that offering Vision Film in this way was [✄].

[54] We noted that one of the reasons why OTT pay-TV retailers might be able to price more aggressively than traditional pay-TV retailers and/or might have more flexibility to offer their services on an unbundled basis was because they benefited from lower SACs compared with traditional pay-TV retailers (see Section 5).

(a) It was possible for many households to take up a movie service delivered over the Internet. OTT pay-TV retailers can already reach up to 76 per cent of households[55] (ie those with a broadband Internet connection) and many consumers individually on mobile devices (see paragraph 2.16). Moreover, this reach is expected to increase further in the future. (In contrast, we noted that Virgin Media's cable platform was available to approximately 50 per cent of UK households.)

(b) Most consumers of OTT services did not need to incur any significant distribution costs for accessing these services because they already had broadband access of sufficient speed (although some may have to pay additional charges if their ISP agreement had too low a broadband usage cap or if their Internet service was charged on a usage basis (for example, with some mobile viewing)).[56]

(c) Most consumers of OTT services also did not need to incur any significant additional hardware costs in order to be able to view the service on a TV,[57] as they already owned a suitable device (eg a laptop with an appropriate video/audio port, games console, STB, Internet-connected TV or Blu-ray player, tablet or smartphone).[58] According to data collected by Ofcom in January to February 2012, over half of households had a games console connected to a TV (52 per cent); of households with a TV, 5 per cent had a 'smart TV'; almost half of adults who personally used a mobile phone had a smartphone (43 per cent); 17 per cent of households had a Blu-ray player or HD DVD player; and 11 per cent had a tablet computer (see paragraph 2.152).

7.113 We noted that the ability of OTT pay-TV retailers to access consumers was likely to continue to increase as more consumers adopted the necessary technology and as consumers' viewing habits changed (see Section 2). We also noted that YouView had announced that its service would be available to consumers in 2012[59] and that this service was widely expected to increase significantly consumer usage of OTT services (see paragraph 2.164).

7.114 We also noted that LOVEFiLM and Netflix could seek to distribute their SVOD services to consumers via the traditional pay-TV retailers (ie Sky, Virgin Media and BT). [✂][60]

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[55] http://stakeholders.ofcom.org.uk/binaries/research/cmr/cmr12/CMR_UK_2012.pdf , pp4 & 25.
[56] LOVEFiLM told us that its minimum recommended speed was 2 Mbits/s, although Netflix on its website stated that its minimum recommended speed was 0.5 Mbits/s. We noted that, as at November 2011, 86 per cent of broadband customers (excluding superfast broadband customers) were receiving speeds of 2 Mbits/s or more. Whilst we recognized that the actual average broadband speed (which in part determines the quality of the viewing experience) received by consumers may be lower due to a number of factors (eg because of traffic congestion, overheads associated with sending data across a network and the performance of the servers to which the consumer is connecting), we noted that to some extent Ofcom accounted for this by identifying those connections which had a modem sync speed of more than 2.2 Mbits/s, thereby allowing for a 10 per cent overhead on the connection (Ofcom Infrastructure Report 2011). A proportion of these customers could receive higher speeds by switching to alternative packages, such as superfast services offered over cable networks or new fibre-based products being deployed by BT (as at November 2011, 58 per cent of UK premises had the option to take superfast broadband services) (Ofcom Infrastructure Report, November 2011), and we also noted that Ofcom had said that the difference between the monthly rental fees for 'superfast services' (those with an 'up to' headline speed of 30 Mbits/s or more) and 'current generation' services (which have a lower headline speed) is often relatively small (Ofcom UK fixed broadband speeds, November 2011). In our view, this data indicated that the majority of broadband connected households would not need to incur any significant additional costs in order to receive a viewing experience of an adequate quality. We also noted that customers might be willing to accept a lower level of quality for a service that was not premium priced.
[57] We noted that consumer research indicated that consumers preferred watching VOD and, in particular, movies by VOD on a TV, in a more relaxed 'living room' atmosphere (paragraph 2.151).
[58] Netflix told us that the emergence of application marketplaces and/or general web browsers on certain Internet-connected devices had removed many of the technical challenges that existed in previous years.
[59] In July 2012, YouView had a media launch of its service and announced that it was in trials with 2,200 users (see paragraph 2.11).
[60] We understood [✂].

7.115 Overall, in our view, an OTT pay-TV retailer, such as LOVEFiLM or Netflix, was likely to face fewer difficulties than a traditional pay-TV retailer in attracting subscribers to its movie service because it could generate new consumption from the large pool of potential customers who were not currently pay-TV subscribers and also because it was likely to be more effective in encouraging current traditional pay-TV subscribers to take up its service, whether they considered it to be a complement to their existing traditional pay-TV subscription or a substitute.

7.116 We did a rough calculation to see if it was plausible for LOVEFiLM or Netflix to acquire the FSPTW rights of one major studio on the basis of their current business models, pricing and subscriber forecasts. As noted above, in our view, the amount that LOVEFiLM or Netflix would be willing to bid for a major studio's FSPTW rights would be determined by the incremental value of adding this content to its service. In principle, this would depend on *(a)* how many new subscribers it expected to attract as a result of this content and/or *(b)* how much more it expected to be able to charge existing customers due to this extra content.

7.117 In practice, it was not straightforward to model what the optimal balance between increasing prices and acquiring/retaining subscribers would be in order to recoup most effectively the cost of acquiring a major studio's FSPTW rights. Therefore, we assumed, for the purposes of our calculation, that prices would not be increased. Whilst we recognized that this may not capture the approach taken by all prospective bidders,[61] [✂], [62] [✂].[63]

7.118 We also noted that, in the short term, many firms focused on subscriber growth. We noted, for example, that Netflix, in its quarterly reporting to shareholders, put considerable emphasis on the growth in its subscriber numbers.[64] Therefore, it seemed to us that some OTT pay-TV retailers could see strategic benefit in seeking subscriber growth through the acquisition of additional high-profile content even if the costs were not recovered through additional subscription revenue in the short term. However, we noted that this consideration would not be captured by the calculation we conducted (which considered how many subscribers Netflix/LOVEFiLM would need to recruit/retain (over and above the number they would have in the absence of the content) in each year of the agreement in order to cover the annual cost of the new content rights).

7.119 For the purposes of this calculation, we assumed a cost of £[✂] million a year for a typical major studio's FSPTW rights.[65] We found that, at this cost and assuming a retail price of £5.99, an OTT retailer would have to attract (or retain by virtue of achieving lower churn) between [✂] and [✂] extra subscribers (compared with what it would have achieved without the content) to cover the additional cost.[66]

7.120 Whilst we recognized that this calculation relied on a number of limiting assumptions (see paragraphs 7.130 to 7.132), given all the evidence we reviewed, including the growth to date of the OTT services of LOVEFiLM and Netflix, their activities in other markets and their forecasts for the UK (see Appendix 4.2), it did not appear to us that it was implausible for an OTT retailer to bid successfully for a major studio's FSPTW

[61] [✂]
[62] [✂]
[63] [✂]
[64] [✂] We noted that, in the past, Sky had [✂], eg with its target of reaching 10 million subscribers in the UK and Republic of Ireland by 2010.
[65] [✂]
[66] This approach assumed additional costs (including taxes) of 0 to 20 per cent of the rights costs.

rights.[67] We also noted that Netflix had pursued a similar pricing strategy (ie about $8 per month) in each territory in which it operated and that this price point had not deterred its willingness to bid for FSPTW rights in other territories.

7.121 We considered whether Sky would for the foreseeable future be able to outbid LOVEFiLM and/or Netflix because it has more subscribers and charges a higher incremental price for its movies service. We noted that what mattered to Sky was the incremental effect on Sky's business of losing the content (in lost customers or lower prices). We calculated that, in order for Sky to be able to bid more than, say, £[✂] million a year for a typical major studio's FSPTW rights, and assuming no changes to its retail or wholesale prices, it would need to believe that this content enabled it to retain more than between [✂] and [✂] customers,[68] ie [✂] per cent of its current Sky Movies subscriber base, which represents roughly between [✂] and [✂] of what an OTT retailer would need to acquire.[69] In our view, it was not clear that Sky would believe that the FSPTW content of one typical major studio would enable it to retain this many customers. In this scenario, Sky would still offer subscribers the content of five major studios (and some non-major studios) and it was not clear to us that the loss of one major studio would be that significant (see paragraphs 7.84 to 7.96 on the role of complementarities).

7.122 We noted that, while there were some similarities, there were also a number of differences between the OTT services of LOVEFiLM and Netflix and Sky Movies (whether distributed through a traditional pay-TV platform or on Now TV). In particular, as at the date of our report, the OTT services of LOVEFiLM and Netflix had much less FSPTW content than Sky Movies but offered a larger number of movies (and non-movie content) and cost significantly less than Sky Movies (see Appendix 4.2). Given this market positioning of their services, it appeared to us that, compared with Sky, the benefits LOVEFiLM and Netflix would obtain from adding more FSPTW content were likely to become exhausted at a smaller number of studios. We noted that the services of LOVEFiLM and Netflix in the other territories in which they operated (in terms of the FSPTW content offered) supported this view. Overall, the evidence suggested that LOVEFiLM and Netflix could see significant value in acquiring the FSPTW rights of one or two major studios but were less likely to see value in acquiring the FSPTW rights of a third major studio or more.

- *Summary on access to sufficient consumers to monetize a bid*

7.123 We recognized that Sky continued to have many more subscribers than either LOVEFiLM or Netflix and, for this reason, in the short term, we expected it to continue to have some advantage when bidding for rights, due to its ability to monetize more effectively the value of the rights it gains and bid with less risk. However, we believed that LOVEFiLM and/or Netflix could have an incentive to bid for at least one major studio's FSPTW rights in order to attract additional subscribers and we noted that, as they increased their subscriber numbers, we expected their ability to monetize the value of FSPTW rights to improve further and their risk when bidding to reduce (in part because the value of the bid they could make would rely less on the number of new subscribers they could win and more on the number of subscribers

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[67] As at 31 May 2012, LOVEFiLM had gained [✂] new paying subscribers to packages which include its unlimited SVOD service since the end of November 2011 (around the time when it repackaged its services) to bring the total number of subscribers on such packages up to [✂]; and Netflix had gained [✂] paying subscribers to its service since launch in January 2012 (see Appendix 4.2). At the end of 2014, LOVEFiLM forecast having [✂] subscribers (a net gain of [✂] subscribers from the end of 2011), while Netflix [✂] forecast [✂]. LOVEFiLM told us that its forecasts represented the growth required to achieve profitability given the expected level of investment needed in digital content in order to build a credible and competitive service, which caused us to put less weight on these numbers. Netflix told us that [✂].

[68] Depending on whether one assumed that customers who were retained pay £8 or £16.

[69] Based on a Sky Movies subscriber base of [✂] million [✂].

they could retain (or the revenue they could earn from existing subscribers)). Therefore, we believed that, in the medium to longer term, Sky's bidding advantage was likely to erode. We believed that changes in consumer behaviour and technological developments would facilitate OTT pay-TV retailers expanding their customer bases, and so would reduce Sky's historic bidding advantages to some extent.

Parties' responses

7.124 In response to our working paper on market developments and our revised provisional findings, BT and Virgin Media raised a number of points, which can be grouped as follows:

(a) We had overstated the pool of customers who would be able and prepared to subscribe to an OTT service.

(b) Our rough calculation understated the number of subscribers that OTT retailers would need to attract, overstated their ability to increase prices and did not consider differences in profitability across business models.

(c) Our views on the prospects for OTT retailers in winning FSPTW rights overstated their advantages and failed to take into account many of the disadvantages they faced.

(d) Our views were based on assertions in relation to complementarities and failed to take into account Sky's strategic incentives.

(e) Our views failed to take into account head-to-head competition between OTT retailers, the launch of Now TV and the possibility that both LOVEFiLM and Netflix might exit.

We present and discuss these five arguments in turn.

- *The pool of customers who would be able and prepared to take an OTT service*

7.125 Virgin Media said that, despite the increasing proliferation of connected devices, the number of households which had access to OTT services was still limited. Virgin Media quoted the TV Licensing Telescope Report, which estimated that there would be only 1.4 million Internet-connected TVs in homes at the end of 2012. Virgin Media also quoted an Enders Analysis report which said that, as of January 2012, even if all Internet-connected devices were taken into account, only around 4 million households (ie 15 per cent of all UK households) would have had access to an Internet-connected device. Virgin Media said that, whilst this number was expected to grow, the number of Internet-connected households would continue to limit the number of potential customers available to Netflix and LOVEFiLM for quite some time. Virgin Media also noted that, notwithstanding the growth in the availability of Internet-connected TVs, it was not clear that customers were in fact using their 'connected' functionality. BT said that, while in the UK there were [✂].

7.126 BT told us that we should not be so sanguine about OTT customers not having to incur additional costs in order to be able to receive the services of Netflix and LOVEFiLM. Virgin Media made a similar point. BT said that:

(a) There could be substantial technical limitations with an OTT service which affected the quality of the service delivered, depending on the customer's Internet service.[70]

(b) LOVEFiLM recommended a minimum actual broadband speed of 2 Mbits/s for SD streaming, and over one-quarter of the general FAQs in its 'Help Centre' related to potential technical issues with its service; moreover Ofcom had found that approximately 14 per cent of residential broadband connections currently operated at below 2 Mbits/s.

(c) ISP download limits and limited broadband speeds in some areas of the country could affect both the quality of streamed services and/or the overall cost of receiving OTT services from Netflix and/or LOVEFiLM.

(d) Our February 2012 survey highlighted that almost half of respondents experienced broadband problems at least sometimes, and 16 per cent of respondents were subject to a monthly download limit on their broadband service. BT said that this evidence suggested that a reasonable proportion of Netflix and LOVEFiLM customers were likely to incur some degree of additional cost, either in terms of increased broadband charges or in the form of lower quality or an unreliable service.

7.127 BT said that the need for multiple devices to access multiple services (eg an STB to access a traditional pay-TV service and an Xbox to access an OTT pay-TV service) was also a barrier to subscribing to multiple services, even where they were all available via the same TV set.[71] BT said that OTT pay-TV retailers would need to overcome this further hurdle in persuading potential customers to subscribe to their services. Virgin Media said that there were significant barriers to consumers 'mixing and matching' subscriptions to movie services and their choice of pay-TV service due to the hassle associated with maintaining two retail subscriptions and difficulties caused by a lack of integration between OTT and traditional pay-TV services.

7.128 We considered these points but, whilst we accepted that entering into two subscriptions may entail some[72] administrative inconvenience and some consumers may experience a lack of integration between OTT services and existing pay-TV services, in our view, these factors were unlikely to outweigh all the other positive attributes of the new OTT services for all customers (see paragraph 6.129). In our view, the evidence suggested that the ability of OTT pay-TV retailers to access consumers was likely to continue to increase as more consumers adopted Internet-connected technology and as consumers' viewing habits changed (see Section 2 and paragraph 7.113).

[70] BT told us that OTT delivery could not be relied upon consistently to deliver a picture quality to the TV set that is likely to meet consumers' expectations of TV broadcast standard quality and, at times when line speed capabilities become too low, the OTT TV service would simply cease to work. BT said that it was possible to set a minimum quality level threshold to ensure an OTT service consistently delivered a broadcast quality service but this would [✄].

[71] BT said that if a consumer had a Sky STB, for example, they were likely to wish to view all services through it and so a single common interface was a distinct advantage. It said that it was likely that such consumers would view a requirement to close their Sky interface and open a different interface on their Xbox (probably using a different controller) as a significant inconvenience.

[72] We noted that subscribers might be reluctant to take up a self-retailed channel(s) if it meant having to enter into two separate retail agreements (see Appendix 7.5 (paragraph 22*(a)*), depending upon the nature of those agreements. In that context, we noted that this would arise if taking up or maintaining a second retail subscription were cumbersome (for example, because it involved contacting a call centre or regularly paying a second bill) or if it required the customer to enter into a second fixed-term contract, but it would not tend to arise to the same degree if entering into, or exiting from, the second contract was straightforward (as we expected would be the case in relation to a subscription to LOVEFiLM or Netflix).

- *Our rights calculation*

7.129 BT told us that it agreed that the maximum amount that an entrant would be willing to bid for FSPTW rights would depend on the incremental impact on its profitability of including this content in its service. Based on the information available to it, BT said that it believed that £45 million was a reasonable annual cost to include in such a calculation[73] and that, on this basis, Netflix would need to recruit and retain approximately 750,000 new subscribers, whilst LOVEFiLM would need to recruit and retain approximately 900,000. BT said that:

(a) Such an approach assumed that all the gross revenue (excluding VAT) from those new subscribers could be deployed to meet the FSPTW rights cost and that no other costs or taxes would be deducted from those revenues, which was a heroic assumption.[74] BT also said that even though OTT retailers may not need to fund the cost of reception equipment, they would still need to incur very substantial marketing costs and fund wide-ranging subscriber acquisition offers.[75]

(b) Given the time needed to recruit new subscribers (due to reasons such as the customer inertia which we had identified), Netflix and LOVEFiLM would need to recruit and retain more new subscribers than these figures by the end of the licence period in order to compensate for the fact that they would not have any of these additional subscribers at the start of the period.

7.130 In relation to *(a)*, we accepted that our calculation was of an approximate nature. However, it was not clear to us that acquiring FSPTW rights from a major studio would substantially increase the marketing costs of an OTT retailer compared to the level of marketing expenditure that it would make anyway. While an OTT retailer would no doubt wish to advertise its FSPTW content, this might simply replace its advertising of other content.

7.131 Moreover, we noted that, in contrast to Netflix and LOVEFiLM, [✂]. Accordingly, it was not clear that [✂] such as to render our simple calculation over-optimistic. Moreover, we noted that if the content of the sixth studio was not that significant to Sky's customer base, then it would retain very few subscribers by bidding for it and an OTT retailer (considering both the number of subscribers it expected to gain and their profitability) might be able to outbid Sky. What our analysis showed, on the basis of considering the prices, subscriber numbers, international experiences and forecasts of LOVEFiLM and Netflix, was that this was not implausible (see paragraph 7.120).

7.132 In relation to *(b)*, we agreed that it would take time for Netflix and LOVEFiLM to recruit the additional subscribers required to monetize a bid (so that in practice the figures we quoted should be viewed as the average annual incremental number that needed to be recruited over the period). However, we took this into account in

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[73] Virgin Media also quoted this figure to us (see footnote to paragraph 7.129*(a)*). It told us that this figure was reached by dividing the figure that appeared in Sky's 2009 annual report for Sky Movies programming cost (£278 million) by six. Virgin Media said that, although this covered all costs, it expected that the output deals with the major studios would represent the vast majority of these costs. BT said that it believed £45 million was an appropriate annual cost as it was a reasonable estimate of the average cost of FSPTW rights (notwithstanding its understanding that [✂]).

[74] In its response to our August 2011 provisional findings, Virgin Media also said that, on the basis of an assumed annual cost of approximately £45 million a year for the exclusive rights to the FSPTW content of a major studio, and an assumed three-year contract, it was implausible that either Netflix or LOVEFiLM could successfully outbid Sky on an economically sustainable basis (particularly at a monthly price of, respectively, £5.99 and £4.99 when Sky by comparison had between 4 million and 5 million subscribers to Sky Movies paying an incremental price of £16).

[75] Virgin Media also said that high churn levels might be expected in circumstances in which there was a significant degree of trialling and use of time-limited free offers and discounts. Virgin Media said that high levels of SACs and marketing costs would need to be incurred in order to attract the very significant numbers of new subscribers necessary to fund the acquisition of FSPTW rights.

arriving at our view that recruiting such a number was not implausible (see paragraph 7.119).[76]

7.133 Virgin Media noted that if Netflix and/or LOVEFiLM were to raise their prices, this would limit their ability to attract low valuation customers. BT made a similar point and said that if Netflix and LOVEFiLM were, for example, first to recruit 1 million subscribers before bidding for and acquiring the FSPTW movie rights of one major studio at a cost of approximately £45 million a year, they would still have to increase their retail prices by £4.50 per month (ie 90 per cent in the case of LOVEFiLM and 75 per cent in the case of Netflix) in order to cover the costs of these rights. BT said that existing subscribers, particularly the price-sensitive ones whom it said we believed would be attracted to the OTT retailers' offerings, would not accept such dramatic price increases.[77] BT said that if Netflix or LOVEFiLM were to increase its retail price, it would necessarily find it harder to recruit and retain subscribers and so would not achieve the growth needed to cover the cost of FSPTW rights from a major studio. BT added that this was precisely the concern which commentators had identified in respect of Netflix in the USA and was why Netflix's share price had not recovered from its precipitous fall in 2011. BT also said that, if Netflix or LOVEFiLM tried to cover part of the cost of FSPTW rights from new subscribers and part from increased prices, this would still undermine their ability to operate successfully at lower prices.

7.134 We accepted that an OTT pay-TV retailers' ability to increase its prices significantly could be limited by the need to achieve subscriber growth, and could be inconsistent with the stated strategy of some retailers (see paragraph 7.117). However, in our view, there were a number of strategies which could be adopted, including not changing prices at all and seeking to monetize the value of the rights entirely in subscriber growth, introducing different tiers of service at different prices[78] or combining small price increases with subscriber growth.

7.135 BT also said that our calculation took no account of the material difference in the sizes of the retail subscriber bases of Sky and the OTT entrants. It said that, even if the profitability per subscriber which Sky and the OTT operators could generate from the FSPTW movie rights of one major studio was the same (which BT said we had not established), Sky still had many millions more pay-TV subscribers (and, more importantly, many millions more premium movie subscribers) than the OTT entrants.[79]

7.136 We disagreed with BT's point. In our view, the maximum amount that a bidder will be willing to bid for FSPTW content will depend upon the incremental impact on its long-term profitability of including this content on its service (see paragraph 7.18).[80] What will matter from Sky's perspective is the impact that retaining this content will have on its profitability whereas a rival bidders' bid will be affected by the impact acquiring this content will have on its profitability. Accordingly, whilst it is true that the larger Sky's Sky Movies subscriber base is the more likely it is that its valuation will be higher than that of a rival bidder (because having a large subscriber base increases the number of subscribers a retailer risks losing by not retaining a major studio's FSPTW content), this does not necessarily imply that the retailer with the larger subscriber

[76] We also noted that customer inertia also meant that an OTT retailer could expect to retain some subscribers after a particular contract, such as for FSPTW rights, expired.
[77] BT said that we had not had regard to the substantial churn that was experienced by Netflix last year in the USA when it effectively doubled its retail price for 'dual' subscribers.
[78] [✂]
[79] BT said that if, notwithstanding their smaller subscriber bases, the OTT entrants were to value the FSPTW movie rights more than Sky, they would have to achieve a level of profitability per subscriber from those rights that was simply not feasible.
[80] We noted that BT appeared to agree with this view (see paragraph 7.129).

base will inevitably have a higher valuation of that content (see paragraphs 7.84-7.96).

- *The disadvantages faced by OTT retailers would limit the number of new subscribers*

7.137 BT told us that, whilst OTT pay-TV retailers might have a slight cost advantage over traditional pay-TV retailers in their method of distribution, this would manifestly not be sufficient to enable OTT pay-TV retailers to recruit and retain sufficient premium subscribers to be able to outbid Sky for the FSPTW rights of major studios on a commercially viable basis.[81] BT said that its Customer Premises Equipment cost across its subscriber base was £[✂] per person. It said that, based on its churn rates (where the average customer lifetime for a BT Vision customer is [✂]), fully covering these equipment costs[82] equated to a retail charge per subscriber of £[✂] per month. BT said that, to place this additional cost in context, its monthly ARPU from pay TV was £[✂], meaning that, even net of hardware costs, its monthly ARPU was £[✂], which was [✂].

7.138 However, it seemed to us that the cost advantage of the OTT pay-TV retailers was material and was one of the reasons why Netflix and LOVEFiLM as OTT pay-TV retailers were able to operate successfully without the need for a buy-through requirement (see paragraph 7.111). In our view, this translated into an enhanced ability to acquire price-sensitive subscribers.

7.139 BT also said that:

(a) Experience with Setanta showed that the acquisition of one-sixth of the volume of a particular type of attractive content (in this case, live FAPL rights) would not enable an entrant to compete effectively with Sky nor to recruit sufficient premium subscribers to cover the cost of that content. (Virgin Media said similarly that the significant numbers of new subscribers which would be required in order to justify the investment by LOVEFiLM or Netflix in the FSPTW rights of a major studio would be difficult to achieve with the content of just one major studio, particularly when Sky would have the other five.)[83]

(b) It was unreasonable for us to reach the conclusion that acquiring the FSPTW rights of just one major studio would confer such an advantage on an OTT operator at the retail level that it would enable them quickly to recruit and retain the large number of new subscribers needed to be able to monetize those rights, whilst at the same time arguing that Sky holding the FSPTW movie rights to all six major studios conferred no material advantage on Sky.

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[81] Virgin Media also said that any cost advantages to OTT retailers from having a lower SAC could be undermined by Sky forcing OTT retailers to spend more on SAC through, in particular, its own high and sustained expenditure on targeted marketing.
[82] Excluding any offsetting connection fee which BT may charge in order to assist in defraying hardware costs.
[83] BT said that, even if Netflix and LOVEFiLM managed to recruit and retain reasonably sizeable bases of low ARPU subscribers, they would not be able to outbid Sky for FSPTW movie rights from the major studios on an economically viable basis. BT cited a Macquarie Equity Research report which estimated that, on the basis of LOVEFiLM's and Netflix's current subscriber numbers (assumed to be 1 million between them), the current pricing of their streaming offerings and an assumption that they invested the same proportion of their revenues that Netflix invests in the USA (55 per cent), Netflix and LOVEFiLM could invest £30 million a year in content between them (adjusted for VAT). (The research also noted that its £100 million forecast of spending on content by LOVEFiLM and Netflix assumed a degree of upfront investment to attempt to win market share.) The same research also noted that if Netflix were to achieve a similar proportion of subscribers to that which it had achieved in the USA, it would equate to around 4 million subscribers, which at its current monthly price would represent a content budget of £140 million a year. BT said that, on the basis of these figures, it had calculated that Netflix and LOVEFiLM could spend up to £55 million a year (assuming no margin and expenditure in line with revenues) on their pay-TV businesses, which BT said was [✂].

7.140 We disagreed with these points. In relation to the first, we did not believe that the experience of Setanta was a relevant comparison to make because the position of Netflix and/or LOVEFiLM was different in a number of respects:

(a) In contrast to Setanta, Netflix and LOVEFiLM were not reliant on self-retailing on Sky's platform for distribution, with the limitations on subscriber uptake that this implied (see Appendix 7.5).

(b) It seemed to us likely that packs of FAPL football rights were likely to be highly complementary as many consumers would want to watch all matches of a particular team, which would be spread across packs. Therefore, with only one-sixth of this content, Setanta was reliant on being taken as an add-on to Sky Sports rather than instead of Sky Sports or as a stand-alone product. In contrast, we noted that both Netflix and LOVEFiLM had already licensed rights to a significant volume of 'complementary' content,[84] which could be combined with any major studio FSPTW content to create a compelling service.

7.141 In relation to BT's second point, we recognized that FSPTW content is important to the appeal of Sky Movies (see paragraph 6.59) and that LOVEFiLM and Netflix use FSPTW content (alongside the other key features of their services, such as their price, range of content and accessibility) to attract consumers to their services (see paragraph 4.156). We set out above why we considered that there was a realistic prospect that an OTT pay-TV retailer would outbid Sky for the FSPTW rights of at least one major studio (which involved comparing the incremental value to an OTT pay-TV retailer of having FSPTW rights from one (rather than zero) major studio with the incremental value to Sky of having FSPTW rights from six (rather than five) major studios).

7.142 Virgin Media said that, in practice, there were a number of other factors which would, or might, operate to reduce the number of potential subscribers to Netflix and LOVEFiLM. Virgin Media said that:

(a) The VOD model was not suitable and OTT delivery not optimal for delivering live sports content, so these services would have difficulty attracting customers with demand also for premium sports content.[85]

(b) Netflix and LOVEFiLM would struggle to attract those customers with demand for a high proportion of FSPTW movie content.

(c) Netflix and LOVEFiLM would struggle to overcome the bundling advantages from which Sky benefited, which meant that the incremental cost to a consumer who already subscribed to Sky from taking Sky Movies was considerably less than the stand-alone cost.

7.143 We accepted that the services offered by Netflix and LOVEFiLM would probably be less appealing for customers who already subscribed to Sky Sports or who valued a high proportion of FSPTW movie content (see paragraph 6.110). However, we noted that it was not necessary for Netflix and LOVEFiLM to be able to compete for all existing pay TV subscribers and we found that their products were likely to be

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[84] FSPTW content from non-majors, SSPTW, TSPTW and library content.
[85] Virgin Media added that Netflix and LOVEFiLM could only hope to attract such subscribers where their services were taken as a complement to an existing sports offering. Virgin Media said that this would be challenging in circumstances in which premium sports was sold on top of a basic package of content, as the package would already provide the subscriber with a considerable volume of content and taking an OTT subscription on top would cause the subscriber the inconvenience of dealing with multiple suppliers.

appealing to a wide set of consumers who did not currently subscribe to a traditional pay-TV service, in part because they were offered on a stand-alone basis.

7.144 We also expected the OTT services of LOVEFiLM and Netflix might still appeal to some consumers who valued sports content or a high proportion of FSPTW movie content due, for example, to their range of content or the choice of devices on which they can be accessed or because the consumer valued the convenience of being able to view more than one pay-TV service simultaneously in different rooms. In our view, they would also be appealing to some basic pay-TV subscribers, who could subscribe to LOVEFiLM or Netflix alongside their current pay-TV subscription, and to some existing Sky Movies subscribers who might either switch or subscribe alongside Sky Movies. .

- *Our analysis of complementarities and Sky's strategic incentives*

7.145 BT said that, in practice, a large base of non-premium subscribers did not enable a pay-TV retailer to monetize expensive premium movie rights. BT said that, if a large base of non-premium movie subscribers was all a pay-TV retailer needed to acquire premium movie rights, then Virgin Media (which BT said had several million non-premium movie subscribers) would have been able to acquire such rights.

7.146 We have set out our reasoning as to why, historically, traditional pay-TV retailers faced significant problems in being sufficient confident that they could reach enough subscribers to outbid Sky (see Appendix 7.5)[86] and our reasoning that OTT pay-TV retailers were likely to face fewer difficulties in attracting subscribers to their movie services (paragraph 7.110-7.115). It seemed to us that BT's assertion, in emphasizing the role of 'premium' subscribers, was also challenging the view that the incremental value to Netflix/LOVEFiLM of a major studio's FSPTW rights could be greater than the incremental value of these rights to Sky. We disagreed as, in our view, this did not take due account of the possibility that the value of a sixth studio to Sky could be less than the value of one major studio to a new entrant (in part because of the exhaustion of complementarities).

7.147 Virgin Media said that our analysis of the role of complementarities was characterized by expressions of opinion but contained no empirical evidence and that more importantly we had failed to have regard to the most direct evidence of the existence of complementarities, which was Sky's observed conduct. Virgin Media said that the fact that Sky had sought to acquire the rights of each of the six major studios over a period of 20 years, and had not once allowed itself to be outbid for that content, pointed very clearly to complementarities between FSPTW content not being exhausted before all six major studios were aggregated (or, alternatively, that strategic incentives had driven Sky's behaviour).

7.148 BT said that we were inconsistent in our treatment of strategic/dynamic effects, in so far as we acknowledged the strategic impact on Sky as a broadcaster when it considered whether to retail a third-party service but ignored the strategic effect on Sky as a pay-TV retailer if it were to lose the FSPTW rights of a major studio. Virgin Media also said that we ignored the strategic effect on Sky as a pay-TV retailer if it were to lose the FSPTW rights of a major studio. Virgin Media said that the simplest way to limit the ability of OTT retailers to become more effective competitors, through the acquisition of FSPTW movie content from a major studio, was to outbid them. Virgin Media said that, given the huge disparity in their respective subscriber bases,

[86] Notwithstanding the possibility of encouraging uptake by pay-TV subscribers who were not subscribing to a movie service on their platform (see paragraph 7.66*(a)*), [✂].

and Sky's incumbency advantage, it was simply implausible that the OTT service providers could outbid Sky in circumstances in which Sky was acting strategically.

7.149 We considered what Sky's bidding behaviour told us about the role of complementarities and its strategic considerations and it appeared to us that Sky's behaviour historically in outbidding its rivals for FSPTW content from all six major studios might well have been influenced by strategic considerations as well as by its desire to offer its customers a wide range of movie content. Nevertheless, it was not clear to us that the FSPTW content of a sixth studio was worth more to Sky than to its rivals and, in particular, not to Sky's OTT rivals which had emerged recently (which appeared focused on offering an attractive but more limited range of recent content than Sky). In our view, Sky's OTT rivals were likely to be in a better position to bid for the FSPTW rights of a major studio than Sky's traditional pay-TV rivals principally because of their greater ability to monetize the value of the rights obtained (see paragraph 7.122). It was difficult for us to judge how much Sky might be willing to pay for strategic reasons (and whether this might be more than Netflix or LOVEFiLM might be willing to invest in building their subscriber bases) but this uncertainty was reflected in our conclusion (ie that there was a realistic prospect that one of the OTT pay-TV retailers would be able to outbid Sky for some FSPTW rights from a major studio).

- *The impact of head-to-head competition, Now TV and the possibility of exit*

7.150 Virgin Media said that:

(a) Direct competition between Netflix and LOVEFiLM for the same cohort of customers would inevitably limit the ability of each to grow their subscriber bases.

(b) In respect of those subscribers with lower demand for pay-TV content, OTT retailers would face, in the future, competition from Now TV in circumstances in which Now TV would be able to offer attractive FSPTW movie content from all the major movie studios and, in due course, other content.[87]

(c) We had failed to have regard to the possibility that both LOVEFiLM and Netflix might ultimately be unsuccessful and exit the market. In particular, the UK pay-TV market was one in which a large number of entrants had tried unsuccessfully to enter (including Setanta, Seesaw, Home Choice and IP Vision), and in which major global market participants had chosen not to enter primarily due to the dominant presence of Sky (eg Hulu). Virgin Media said that the failure to have regard to this was particularly striking given our position that OTT pay-TV retailers might be prepared to pay significant sums for premium content to drive their subscriber growth, which was precisely the strategy adopted by Setanta in entering the pay-TV market, and which ultimately forced it to exit.

7.151 On these points we noted that:

(a) Direct competition between Netflix and LOVEFiLM would provide strong incentives for these parties to differentiate their services from one another and gaining FSPTW content from a major studio(s) might be an effective way to do this.[88]

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[87] BT made a similar point. It said that the launch by Sky of Sky Movies on Now TV would, far from alleviating the barriers identified by us, enable Sky to acquire incremental retail subscribers in a way that other pay-TV retailers could not, further growing its installed retail subscriber base and reinforcing the primary barrier we had identified in our August 2011 provisional findings.
[88] [✂]

(b) We had no reason to expect the launch of Sky Movies on Now TV to exacerbate materially the barriers to LOVEFiLM, Netflix, or other possible OTT retailers obtaining FSPTW rights from a major studio(s), in part because Sky's growth of its Sky Movies subscriber base on Now TV was constrained by its objective of minimizing the cannibalization of its Sky Movies subscriber base on its traditional DTH platform (see paragraph 5.157).

(c) We did consider the future prospects of Netflix and LOVEFiLM and, while we could not be certain about future events, we expected at least one OTT supplier to remain in the market in the longer term (see paragraph 5.154).

- *Conclusion on comments of the parties on our analysis*

7.152 On the basis of this analysis, we concluded that there was a realistic prospect that an OTT pay-TV retailer would outbid Sky for the FSPTW rights of at least one major studio in the future. In our view, it was unlikely that either LOVEFiLM or Netflix would gain the FSPTW content of a third or fourth major studio (as the value of this content to Sky was likely to be significantly greater than the value to LOVEFiLM or Netflix). Although Sky might have some dynamic incentive to retain the FSPTW rights of all six major studios in order to restrict the growth prospects of its rivals, which might increase the amount it was willing to bid, it was not clear to us that Sky's rivals would not still be willing to pay more.

Engagement with studios

7.153 While we could not be certain of the commercial incentives of any OTT pay-TV retailer to participate in any given auction process, and ultimately to make the necessary investment to win, [✄].

Comparisons with other territories

7.154 We considered the extent to which the success of both LOVEFiLM and Netflix in acquiring FSPTW content in other territories might be informative for the purposes of our assessment. LOVEFiLM offers the FSPTW content of Paramount in Germany and Netflix offers the FSPTW content of Paramount in the USA (and, until recently, also offered the FSPTW content of Sony Pictures and Disney in the USA) and Paramount and Fox in Canada.

7.155 BT told us that the pay-TV markets in the territories in which Netflix and LOVEFiLM had been able to secure FSPTW rights from a major studio (ie the USA, Germany and Canada) were less concentrated than the pay-TV market in the UK. Virgin Media made a similar point. Virgin Media also said that it was significant that Netflix had the opportunity to secure access to FSPTW content in the USA through negotiations with an aggregator rather than negotiating directly with the studios, with an aggregator potentially having different incentives than the studios. BT said that we should have had regard to [✄].[89]

7.156 [✄]

7.157 Early in our inquiry, prior to the launch of the OTT services of LOVEFiLM and Netflix in the UK, Paramount told us that the fundamental problem which it had faced in the USA was that it could not reach sufficient FSPTW customers via the traditional pay-

[89] [✄]

TV networks and distributors so it had created EPIX to solve this problem (see Appendix 2.4). EPIX had then negotiated the distribution of its service over the Internet with Netflix. Paramount said that if the fees offered by Sky dropped excessively in the UK, then there was space for innovation by the studios and competing distributors with stand-alone SVOD services could emerge, as had happened in Canada and the USA.

7.158 Paramount told us that the deal that it signed with Netflix in Canada displaced legacy deals with Astral Media and Corus Entertainment, both regional pay-TV networks, which, like Sky, had long-held FSPTW content from major studios in their respective territories. Paramount said that Netflix had paid [✂] for its FSPTW content for distribution in Canada above what the incumbents were prepared to offer, and told us that this was firm evidence of the ability of some parties to outbid traditional pay-TV incumbents without needing access to those incumbents' subscriber bases or distribution structures. Paramount said that similar entry was possible in the UK.

7.159 Although we recognized that there were differences between the territories in which LOVEFiLM and Netflix had already licensed FSPTW rights from major studios and the UK, in particular the presence in the UK of a much larger incumbent which had all the FSPTW rights of the six major studios,[90] we noted that the activities of LOVEFiLM and Netflix in other territories suggested that they placed value on this content and that, if an OTT pay-TV retailer expected to increase its subscriber numbers in the UK by gaining the FSPTW content of a major studio, it might be able to outbid Sky.

Sky's internal documents

7.160 Sky provided us with [✂].

7.161 We noted that [✂].[91] Based on figures provided to us by Sky, we calculated that its annual budget for FSPTW movies for 2015/16 was[✂].[92,93]

7.162 Sky also provided us with [✂].[94,95]

7.163 We also noted that, [✂].

7.164 In our view, this evidence taken together indicated that [✂]. It also indicated that [✂]. However, it was not clear that [✂] it appeared to us that an OTT rival might be able to outbid Sky for the FSPTW rights of at least one major studio.

Tying of exclusive linear and SVOD rights

7.165 We considered whether the practices of awarding linear rights and SVOD rights together and on an exclusive basis were barriers to the acquisition of major studio FSPTW rights, because they made it more difficult for an OTT pay-TV retailer focused on offering an SVOD service to outbid Sky, either because it could offer less for the rights (because it was unable to offer the flexibility valued by customers of

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[90] In Canada, Astral had around [✂] million subscribers and Corus had about [✂] million subscribers (Movie Central subscribers), in contrast with Sky's almost 10 million subscribers in the UK (around [✂] million of which subscribe to Sky Movies). We noted that in Germany (where LOVEFiLM holds the FSPTW rights of Paramount), pay-TV penetration is relatively low.
[91] [✂]
[92] Sky anticipated that [✂].
[93] Sky said that [✂].
[94] [✂].
[95] [✂]

offering a linear service) or simply because it would have to outbid Sky's combined bid for linear and SVOD rights (which would be inflated because of a subscriber number advantage derived largely from its position in relation to linear channels).

7.166 We noted that awarding rights exclusively (one form of which was the tying of SVOD and linear rights) gave rise to an auction process which only one bidder could win and, in the past, this had created the conditions for Sky's bidding advantages to take effect. However, we also noted that, in the past, it was the bidding advantages held by Sky which had distorted the auction process and prevented rivals from being able to acquire any packages of FSPTW rights, not the nature of the auction itself. [✂]

7.167 We also noted that, although it was rare for either linear rights or SVOD rights in the FSPTW to be granted non-exclusively, or for these rights to be licensed separately, neither the practice of awarding these rights on an exclusive basis nor the practice of awarding them together appeared to be immutable. Rather, given that a studio's overriding objective is to maximize the value of the exploitation of its movies overall, we would expect either practice to change were the value to the studio overall to increase by doing so.

7.168 Therefore, we found that the licensing of content exclusively (including the tying of linear and SVOD rights) did not, on its own, represent a distinct barrier to the acquisition of FSPTW rights, although it did create the conditions for Sky's bidding advantages to take effect.

7.169 In its response to our revised provisional findings, Virgin Media said that it was uncontroversial that studios would license linear and SVOD rights separately if it was in their commercial interest to do so. However, Virgin Media stated that the relevant question was whether there was a realistic prospect that an OTT retailer would be able to offer a sufficient amount for separate SVOD rights to ensure that the studio was no worse off than offering the linear and SVOD rights exclusively and as a package to Sky. Virgin Media considered this to be unlikely because an OTT retailer would need to outbid Sky, whose bid would reflect the value from both linear and OTT distribution. Virgin Media said that, if an SVOD-only bidder were to bid non-exclusively, Sky could be expected to factor into its valuation the loss of its exclusivity such that the combined valuation would be likely to be lower than Sky's alternative offer for the combined and exclusive package of SVOD and linear rights.

7.170 In its response to our working paper on market developments, Ofcom also told us that the continued bundling of linear and SVOD rights was likely to constitute a barrier to LOVEFiLM and Netflix successfully acquiring the FSPTW rights of the major studios.

7.171 We accepted that offering rights exclusively (and in such a way that SVOD and linear rights are conjoined) meant that OTT pay-TV retailers would likely need to outbid Sky's offer for both linear and SVOD rights. However, it appeared to us that, in order to attract consumers to their services, this was likely to be their intention, recognizing that many consumers would perceive linear and SVOD services as close substitutes. Further, in our view, the licensing of content exclusively (including the tying of linear and SVOD rights) did not, on its own, represent a distinct barrier to the acquisition of FSPTW rights, although we accepted that it did create the conditions for Sky's bidding advantages to take effect. Moreover, we believed that, although Sky might have some advantage from being able effectively to monetize the value of the rights it obtained across both a linear and an SVOD service, this would not preclude an OTT rival from bidding successfully against Sky for the FSPTW rights of a major studio.

The evolution of our findings over the course of our inquiry

7.172 In August 2011 we set out our provisional view that pay-TV products with FSPTW movie content, and Sky Movies which had the majority of this content,[96] were significant to many consumers in their choice of pay-TV provider. This implied that it was necessary for Sky's pay-TV rivals to offer a movie service similar to Sky Movies (in terms of its FSPTW content) to be able to compete effectively with Sky in the pay-TV retail market.[97] We therefore considered whether there were barriers to obtaining sufficient FSPTW content to be able to create such a service.

7.173 In our August 2011 provisional findings, we said that a rival bidder for SVOD rights, seeking to develop an SVOD service which could compete effectively with Sky Movies, would not face the same level of barriers as a rival seeking to establish a new linear movie channel. We noted, in particular, that an SVOD service provider might find it easier to attract some consumers to its service by being able to distribute it directly over the Internet to Internet-connected devices. Nevertheless, at that time, we judged that this rival bidder would still face the same principal barrier faced by a new linear channel provider, which was Sky's incumbency position, with over [✂] million Sky Movies subscribers on its own platform. We said that being able to attract enough subscribers sufficiently quickly in order to justify making an offer which would be valued by the major studios in excess of an offer made by Sky would represent a significant challenge and risk for any potential bidder for these rights.

7.174 However, after the publication of our August 2011 provisional findings, Netflix launched an SVOD-only service in the UK on an OTT basis and LOVEFiLM expanded significantly its OTT SVOD offering, which it also began to offer on a stand-alone basis (ie not bundled with its DVD rental by post service). By the time of our report, both LOVEFiLM and Netflix had acquired FSPTW rights from some non-major studios and both of them had demonstrated a willingness to incur significant risk in order to establish a position in the market for the long term. Nevertheless, we recognized that Sky continued to have many more subscribers than either LOVEFiLM or Netflix.

7.175 In the short term, we expected Sky to continue to have some advantage when bidding for rights due to its ability to monetize more effectively the value of the rights it gained. However, on the basis of [✂]. Based on the evidence we saw, it appeared to us that the barriers facing Sky's OTT rivals to the acquisition of more FSPTW content were lower than we said at the time of our August 2011 provisional findings, were lower than for traditional pay-TV retailers and were eroding further.

Conclusion on barriers to the acquisition of major studio FSPTW content by OTT pay-TV retailers

7.176 Overall, we concluded that:

(a) While we could not be certain of the commercial incentives of any party to participate in any given auction process and ultimately to make the necessary investment to win, [✂].

[96] We understood that, occasionally, a small amount of FSPTW content had been available on other services (eg PictureBox).
[97] In our August 2011 provisional findings, we said that it was likely that the FSPTW content of at least two of the major studios would be required, supplemented with FSPTW content from some non-major studios, SSPTW content and library content. This assessment was affected by our views on significance at the time. The evidence on which we based this finding, along with a discussion of our revised views, is set out in Appendix 7.1.

(b) As LOVEFiLM and Netflix increase the numbers of their subscribers, their ability to monetize the value of the rights they obtain will improve and they will incur less risk when bidding, eroding further Sky's bidding advantage.

7.177 Overall, it appeared to us that there was a realistic prospect that an OTT pay-TV retailer would be able to outbid Sky for the FSPTW rights of at least one major studio in the future.[98]

Overall assessment of barriers

7.178 Over the last 20 years, Sky has been the only party which has acquired the FSPTW rights of any major studio in the UK. In our view, traditional pay-TV rivals, or content aggregators seeking to supply traditional pay-TV rivals, have historically faced material barriers to acquiring the FSPTW rights of the major studios because Sky's position, with a substantial incumbent base of Sky Movies customers, has meant that, when bidding for rights, Sky has been more confident relative to its rivals that it will be able to monetize the rights it acquires. This has enabled Sky to bid more for the rights than its rivals.

7.179 In our view, traditional pay-TV rivals in the past could not rely on being able to circumvent these disadvantages, either by retailing directly to consumers via Sky's DTH satellite platform (due to marketing costs and the disadvantages it would face relative to Sky in being unable to bundle its channel with Sky's other channels and services) or by wholesaling to Sky (due principally to the risks associated with entering into a commercially attractive wholesale arrangement with Sky).

7.180 However, we found that the barriers faced by OTT pay-TV retailers in acquiring FSPTW content were lower than for traditional pay-TV retailers principally because they were likely to face fewer difficulties than traditional pay-TV retailers in attracting subscribers to their movie services. This was because they could generate new consumption from the large pool of potential customers who were not currently pay-TV subscribers and also because they were likely to be more effective in encouraging subscribers to traditional pay TV to take up their services as this would not require switching traditional pay-TV provider. We noted that, in the future, as the customer bases of these providers increased, their ability to monetize the value of the rights they obtained would improve and they would incur less risk when bidding, eroding Sky's bidding advantage further.

7.181 We observed that both LOVEFiLM and Netflix had each acquired FSPTW content from non-major studios, [✂]. We also observed that, [✂]. While we could not be certain of the commercial incentives of any party to participate in any given auction process and ultimately to make the necessary investment to win, in our view, there was a realistic prospect that, in the future, an OTT pay-TV retailer would be able to outbid Sky for the FSPTW rights of at least one major studio. [99]

7.182 We also observed (although our decision did not rest on this) that, if one or more OTT pay-TV retailer acquired the FSPTW rights of a major studio, this would further increase the extent to which its OTT service was a substitute for Sky Movies, and further reduce the already very small proportion of consumers for whom the FSPTW content on Sky Movies was significant in their choice of traditional pay-TV retailer (see Section 6).

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[98] [✂]
[99] [✂]

8. Sky's wholesale supply

Introduction

8.1 Our terms of reference referred to the wholesale supply and acquisition of packages including Sky Movies channels. In Section 3 we set out how matters relating to the wholesale supply of Sky Movies fell to be considered in the context of our theory of harm, ie that one of the four circumstances we would expect to be present if our theory of harm was correct was that there was limited availability to other pay-TV retailers both of movie content in the FSPTW and of Sky's movie products which included this content.[1] Thus, if we found that the other parts of our theory of harm were made out, we would need to consider whether retail pay-TV competition might nevertheless be working effectively in light of Sky's wholesale supply of Sky Movies (and the terms of this supply) to its rival pay-TV retailers.[2]

8.2 We also noted in Section 3 that, in the event we found that FSPTW content was not significant to subscribers in their choice of traditional pay-TV retailer, it seemed implausible as a matter of principle that the terms of Sky's wholesale supply of Sky Movies could cause Sky's rivals to be at such a disadvantage when competing for pay-TV subscribers as to harm competition.[3] Indeed, this appeared to be a necessary implication of such a finding on the issue of significance. For this reason, and given our finding on significance (see section 6), we did not believe it was necessary for us to examine issues in relation to wholesale supply by reference to the questions we posed under part *(d)* of our theory of harm in order to reach a conclusion overall as to whether our theory of harm was made out.

8.3 Nevertheless, we believed that it was appropriate to consider the extent to which Sky's conduct with respect to the wholesale supply of Sky Movies might inform an assessment of the significance of FSPTW content. As a matter of principle, in circumstances where FSPTW content is not significant to subscribers' traditional pay-TV subscription decisions, we would not expect Sky to have a strategic incentive to limit the availability of Sky Movies[4] in order to provide it with an advantage over its rivals in competing for subscribers in the pay-TV retail market. In such circumstances, it would be likely to be profitable for Sky to seek the wider distribution of Sky Movies rather than to use the availability of Sky Movies to increase its sales of traditional pay-TV packages. Therefore, conduct which suggested that Sky was seeking to restrict the wholesale distribution of Sky Movies might, in some circumstances (see paragraph 8.4), suggest that Sky considered FSPTW content to play a role in driving the take-up of its pay-TV packages; and, conversely, conduct which suggested Sky was seeking broad wholesale distribution of Sky Movies would tend to (but need not necessarily) support a finding that FSPTW content was not significant to consumers in their traditional pay-TV subscription decisions.

8.4 In practice, however, we observed that Sky's decisions as to whether or not to supply Sky Movies to another pay-TV retailer (and upon what terms) were subject to a range of considerations, and the commercial relationships between Sky and its rivals were

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[1] This is on the basis that Sky Movies has the majority of movie content in the FSPTW.
[2] In such circumstances, the availability of Sky's movie products which include FSTPW content would be 'limited' if either the price or non-price terms of supply of Sky Movies-only products or the (incremental) price or non-price terms of the Sky Movies element of combined Sky Sports/Sky Movies products were set at levels which would put Sky's rivals at a material disadvantage to Sky when retailing packages that contained Sky Movies. In relation to price, we considered directly whether price terms were such as to place Sky's rivals at a material disadvantage compared with Sky when retailing packages which contained Sky Movies; in relation to non-price terms, we considered this question with reference to a counterfactual in which there were no barriers to the acquisition of FSPTW rights.
[3] See paragraph 3.11.
[4] For example via the imposition of detrimental price or non-price terms.

not limited to the terms of supply of Sky Movies. As a result, we considered that the inferences which could reasonably be drawn from Sky's conduct in relation to the supply of Sky Movies for the assessment of the significance of FSPTW content were limited. Nevertheless, if there had been clear evidence which indicated that Sky was seeking to restrict the supply of Sky Movies in order to constrain its rivals' ability to compete with Sky for pay-TV subscribers, this would have cast some doubt on the views we had reached on the significance of FSPTW content based on other evidence.

8.5 In this case, our assessment of Sky's wholesale supply of Sky Movies was further complicated by the fact that much of the evidence[5] (particularly in relation to non-price terms) related to matters which were in the past and therefore had to be considered in that context. Either the relevant issue had been resolved[6] and/or the evidence related to a period when it seemed likely that Sky Movies was more important to retail pay-TV competition than was the case at the time of our report. Therefore, in our judgement, it was not appropriate to give undue weight to such historical evidence as it would not necessarily be informative about the current significance of FSPTW content in pay-TV retail competition.

8.6 With the above limitations in mind, we considered whether the evidence before us in relation to the price and non-price terms of Sky's wholesale supply of Sky Movies was such as to cast doubt on our views on the significance of FSPTW content (and Sky Movies) based on other evidence (see Section 6). In this section we set out our reasoning on this issue.[7] Relevant conclusions are summarized in Section 6 (see paragraphs 6.137 and 6.138), and reflected in our overall findings on significance (see paragraph 6.165).

Overview

8.7 We discuss first the price terms of Sky's wholesale supply (see paragraphs 8.12 to 8.20 and Appendix 8.1), before discussing the non-price terms (see paragraphs 8.21 to 8.24 and Appendix 8.2). Having regard to representations received in the course of our inquiry, and taking into account recent developments where relevant, we found that, in relation to price, it was not clear that rivals were at the time of our report at a material disadvantage when retailing Sky Movies; and, in relation to non-price terms, the relevant evidence was inconclusive as to whether rivals were, or ever had been, at a material disadvantage when retailing Sky Movies. Importantly, we found that the evidence on Sky's conduct in terms of its wholesale supply was not such as to cast doubt on our views on the significance of FSPTW content to consumers' pay-TV subscription decisions, which we had reached on the basis of other evidence.

8.8 We also found that a number of developments with respect to Sky's wholesale terms of supply were consistent with our finding that the significance of Sky Movies to consumers' pay-TV subscription decisions had fallen, namely Sky's decision to reduce [✂] the wholesale prices of certain of its products incorporating Sky Movies [✂] and its entry into an agreement with TalkTalk for the distribution of Sky Movies on a wholesale basis.[8]

8.9 We also noted that [✂].

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[5] We received a substantial amount of evidence on Sky's conduct in relation to wholesale supply throughout our inquiry, in particular from Virgin Media and BT.
[6] In such circumstances it was often difficult to establish whether any perceived delay was the manifestation of strategic incentives to restrict supply or delays associated with the normal course of negotiations.
[7] The evidence in relation to both historical and current issues raised by parties with respect to the wholesale supply of Sky Movies is set out in more detail in the appendices to this section.
[8] See Appendix 8.2, paragraph 76.

8.10 Having found that the evidence in relation to Sky's conduct was not sufficient to cast doubt on our findings on the significance of FSPTW content, we did not consider that it was necessary to examine further Sky's wholesale terms of supply in order to confirm whether or not our theory of harm was made out (for the reasons set out in paragraph 8.2).

8.11 Notwithstanding these findings, based on the evidence we saw,[9] we noted that, if there was a material change of circumstances with respect to Sky's wholesale supply of Sky Movies, this might warrant renewed scrutiny of these issues by Ofcom (though clearly not all developments in relation to the wholesale supply of Sky Movies that might appear adverse to the interests of other pay-TV retailers would be such as to cast doubt on our findings on the central issue of the significance of FSPTW content (see paragraph 8.4)).

Sky's wholesale supply of Sky Movies

Price terms of wholesale supply

8.12 Both Virgin Media and BT argued that the price terms upon which Sky supplied (or offered to supply) Sky Movies on a wholesale basis did not enable third parties to compete effectively in the pay-TV retail market. Virgin Media told us that Sky Movies was provided to Virgin Media on uneconomic terms, providing Virgin Media with little or no incentive to promote and market Sky Movies actively. BT told us that as BT Vision and TUTV were unable to offer an FSPTW movies service, they were both unable to compete effectively for subscribers to their platforms.[10]

8.13 In the course of our inquiry, Sky [✂] reduced the wholesale prices of certain of its products incorporating Sky Movies [✂]. Our consideration of Sky's wholesale pricing therefore took account of both the historical position and the recent wholesale price reductions (the detailed assessment is set out in Appendix 8.1).

8.14 As a result of Sky's wholesale price changes, the cable rate-card price for [✂] at the time of our report was [✂] Sky's incremental retail price, [✂] the cable rate-card price for [✂] about [✂] per cent [✂] its incremental retail price. However, we noted that [✂]. Whilst the cable rate-card price for [✂] in excess of the incremental retail prices of these products, our analysis indicated that [✂].[11] Accordingly, regardless of our position on the significance of Sky Movies to consumers' pay-TV subscription decisions, it was not clear that other traditional pay-TV retailers were, at the time of our report, at a material disadvantage to Sky in relation to price when retailing Sky Movies.

8.15 One implication of the recent reduction in the wholesale price of certain of Sky's products incorporating Sky Movies was that a historical comparison of the take-up of Sky Movies across different platforms was of limited value.

8.16 We reviewed Sky's internal documents to investigate Sky's rationale for the changes to its wholesale prices. [✂]

8.17 Sky told us that [✂].

[9] We recognized that the statements and actions of parties might have been influenced by our inquiry and that there were many uncertainties in relation to the future negotiations for the wholesale supply of Sky Movies.
[10] See paragraph 5.52.
[11] See Appendix 8.1, paragraph 27.

8.18 Sky also told us that [✂], BT told us that its discussions with Sky regarding the wholesale supply of Sky Movies [✂].[12]

8.19 In our view, there were many uncertainties about future negotiations between Sky on the one hand, and Virgin Media and/or BT and/or other pay-TV retailers on the other, and we recognized that the statements and actions of all parties concerned could have been influenced by our inquiry. However, taking the evidence in the round, we found that Sky's reduction in its wholesale prices for certain of its products which incorporate Sky Movies was at least indicative of a shift in the balance of advantage to Sky between conserving its position in traditional pay-TV and maximizing sales of Sky Movies.[13] In our view, this was consistent with a fall in the significance of Sky Movies to the subscription decisions of traditional pay-TV subscribers. We were not persuaded by the arguments put forward by Virgin Media and BT as to the implications of these price changes (see paragraphs 6.142 to 6.147) and, in particular, we were not persuaded that no weight should be attached to this evidence in the context of our findings on significance. Importantly, in our view, the conduct we observed was not such as to cast doubt on our findings on significance (ie we were not persuaded that there was any sufficiently clear and compelling evidence that Sky was restricting its wholesale supply of Sky Movies in terms of price in order to limit the ability of its pay-TV rivals to compete for subscribers).

8.20 While in light of our finding on significance it was not necessary to conduct a detailed appraisal of Sky's wholesale prices, we observed that, even had we reached a different view on significance, the recent wholesale price reductions by Sky meant that it was no longer clear that the price terms upon which Sky supplied Sky Movies to its rivals resulted in 'limited wholesale availability' of FSPTW content (and Sky Movies) such as to place them at a material disadvantage to Sky when retailing Sky Movies.

Non-price terms of wholesale supply

8.21 In our August 2011 provisional findings, in the context of our provisional view that all of the other three parts of our theory of harm were made out, we also considered whether the non-price terms of supply by Sky of Sky Movies to other pay-TV retailers resulted in the limited availability of FSPTW content and Sky Movies, and thereby restricted the ability of Sky's pay-TV rivals to compete with Sky. Our discussion of the evidence in relation to this area is set out in Appendix 8.2.

8.22 In our August 2011 provisional findings we said that, although Sky had made its movie products with FSPTW content available to some other pay-TV retailers, it appeared to us that the terms of Sky's wholesale supply of Sky Movies were such that it had a material advantage over its rivals in the pay-TV retail market. We said that, in part, this was because Sky's rivals had been limited to offering the portfolio of Sky Movies products offered by Sky and to offering them in largely the same way in which they were offered by Sky, thereby preventing these rivals from offering movie products in ways which could have been more attractive to their respective subscriber bases and more suited to their respective platforms. In particular, we said that, on the basis of the evidence we had seen at that time, had there been no barriers to the acquisition of FSPTW rights, some of Sky's rivals[14] would have been

[12] For example, [✂]. In June 2012, BT told us that it had still not been able to obtain wholesale supply of Sky Movies and as a consequence was still at a material disadvantage to Sky when retailing movie services, notwithstanding this reduction in certain of Sky's wholesale prices for Sky Movies.
[13] In other words, that it was now more profitable for Sky to seek the wider distribution of Sky Movies rather than to use the availability of Sky Movies to increase its sales of traditional pay-TV packages.
[14] We noted in our August 2011 provisional findings that some of Sky's rivals could have developed a pull SVOD service sooner than Sky because their systems used broadband or cable technology, which included a 'return path'; though we also recognized that [✂].

able to launch a pull SVOD service sooner and Sky's rivals (in particular, Virgin Media) would have enjoyed greater freedom in their ability to differentiate their movies offering (eg by repackaging content/channels and adopting different pricing structures). We said that being able to do these things would have enhanced the ability of Sky's rivals to compete with Sky in the pay-TV retail market. In our August 2011 provisional findings, we judged that the evidence on other areas relating to Sky's wholesale supply was inconclusive.

8.23 In the period between our August 2011 provisional findings and our final report, Sky entered into a wholesale agreement with TalkTalk for the distribution of Sky Movies on a wholesale basis[15] [✂].[16,17] Also, in response to our August 2011 provisional findings Sky raised a number of points disagreeing with our reasoning on this issue and, in our view, several of these points had some merit, which caused us to re-appraise some of the evidence in relation to the non-price terms of Sky's wholesale supply of Sky Movies (see Appendix 8.2).

8.24 Overall, we found that the evidence in relation to Sky's non-price terms of wholesale supply of Sky Movies was inconclusive as to whether Sky had, or ever had had, a material advantage over its rivals or not. We judged that it was not appropriate to place undue weight on some of the more historic evidence as it related to a period when it seemed likely that Sky Movies (which has the majority of FSPTW content) was more important to retail pay-TV competition than appeared to be the case at the time of our report. Importantly, the conduct we observed was not such as to cast doubt on our findings on significance (ie we were not persuaded that there was sufficiently clear and compelling evidence that Sky was restricting its wholesale supply of Sky Movies via non-price terms in order to limit the ability of its pay-TV rivals to compete for subscribers).

Summary

8.25 Our findings on the significance of FSPTW content to consumers in their choice of traditional pay-TV retailer (see Section 6) implied that the terms of Sky's wholesale supply of Sky Movies[18] could not in principle cause Sky's rivals to be at such a disadvantage when competing for subscribers as to harm competition. In such circumstances, we would also not expect Sky to have a strategic incentive to limit the availability of Sky Movies[19] in order to provide it with an advantage over its rivals in competing for subscribers in the pay-TV retail market. We found that, in relation to price, it was not clear that rivals were at the time of our report at a material disadvantage when retailing Sky Movies; and, in relation to non-price terms, the relevant evidence was inconclusive as to whether rivals were, or ever had been, at a material disadvantage when retailing Sky Movies. However, importantly, we found that the evidence on Sky's conduct in terms of its wholesale supply was not such as to cast doubt on our views on the significance of FSPTW content which we had reached on the basis of other evidence. We also noted that changes in Sky's wholesale behaviour, both in reducing its wholesale prices for certain of its products which incorporate Sky Movies and in reaching a wholesale agreement with TalkTalk were consistent with the significance of FSPTW content to consumers in their choice of traditional pay-TV retailer having fallen.

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[15] See Appendix 8.2, paragraphs 76.
[16] [✂]
[17] To our knowledge, there were no other significant changes in the non-price terms of Sky's wholesale supply of Sky Movies to other traditional pay-TV retailers in this period.
[18] Either the price or non-price terms of Sky Movies-only products or the incremental price or non-price terms of the Sky Movies element of combined Sky Sports/Sky Movies products.
[19] For example via the imposition of detrimental price or non-price terms.

9. Competitive effects in the rights market

Introduction

9.1 As part of the concern to be investigated (see Section 3), we hypothesized that any control by Sky of the acquisition and distribution of movie content on pay TV during the FSPTW, as a result of its market power in the pay-TV retail market, might adversely affect the suppliers of FSPTW movie rights and competition between them, in addition to adversely affecting competition between pay-TV retailers.

9.2 The intuition behind this concern was that, if rivals were unable to bid successfully for FSPTW rights against Sky, then studios might be unable to generate competitive tension for their rights, which could enable Sky to drive down prices or enforce worse terms. If Sky had bargaining power in the upstream market, this could give rise to adverse effects on or distortions between studios.

9.3 In evaluating this potential concern, we noted that whether or not the studios had been able to extract the 'competitive' price from Sky for their FSPTW rights could not simply be inferred by the presence of barriers to the acquisition of FSPTW rights (because the presence of rival bidders might constrain Sky's actions in bidding for FSPTW rights to some degree, even if the alternative bidders were ultimately unsuccessful and, further, to the extent that there was limited competition for FSPTW rights, the movie studios could threaten to amend the timing and length of the FSPTW and so exploit any competition that existed for their rights in neighbouring windows).

9.4 We found that, although, at the time of our report, no rival to Sky had ever licensed a major studio's FSPTW content,[1] in the seven years prior to 2011 there had been [✂] occasions when rivals had [✂] to acquire such rights (see Section 7). Moreover, in our view there was a realistic prospect that, in the future, an OTT pay-TV retailer would be able to outbid Sky for the FSPTW rights of at least one major studio (see Section 7).

Assessment

9.5 We considered a range of evidence on whether movie studios had been able to extract the 'competitive' price from Sky for their FSPTW rights or whether Sky had been able to exploit bargaining power. We considered the possible effects on the major studios and the non-major studios separately.[2]

Major studios

9.6 We found that an assessment of trends in the prices paid by Sky to the major studios for FSPTW movie rights was not informative for our purposes. In our view, we could not infer from [✂] trend in prices in the period to 2011 that Sky had [✂] over this period and, in any case, our primary interest was in how the prices the studios obtained compared with some notional 'competitive' level, and price trends could not, on their own, provide many insights on this issue.

[1] We recognized that, on occasion, other parties had licensed a small number of movies from one of more of the major studios which had not previously been shown on pay TV.
[2] We noted that Sky's ability to exercise bargaining power was likely to be inversely related to the importance to Sky of the content which it was seeking to license. It appeared to us that, generally, the output of a major studio was likely to be more important to Sky than the output of a non-major studio, although this might not always be the case.

9.7 Notwithstanding a number of limitations inherent in a comparison between countries,[3] we asked the major studios to provide us with information on their movie revenues in each window in each of ten different countries for a three-year period from 2008 to 2010.[4] We also requested information from them specifically about the FSPTW, including: *(a)* the revenue from each of their five largest licensees in the most recent of these years; *(b)* the fee per subscriber paid for the main category of movies by the largest licensee for each year; and *(c)* the number of subscribers of their largest licensee for each year. We sought to assess whether in the UK, or in any other countries in which only one company holds the FSPTW rights of all six major studios, the major studios obtained less revenue from or agreed worse terms in relation to the licensing of their FSPTW rights than in countries where there was more than one licensee of these rights.

9.8 First, we analysed the relative value of the different windows to the movie studios. This did not clearly indicate that Sky had exercised bargaining power, at least in relation to the major studios. Rather, it suggested that there was no clear relationship between the number of companies holding FSPTW rights and the revenue share attributable to pay-TV.

9.9 We then compared across the geographic markets *(a)* the prices earned by the major studios for their FSPTW rights[5] and *(b)* the major studios' aggregate pay-TV revenue per subscriber from each of their largest licensees. Neither set of data clearly indicated that the major studios had suffered lower prices in the UK from Sky's position as the sole licensee of their FSPTW rights compared with other territories in which there was more than one licensee.

9.10 Our analysis of the terms agreed by the major studios with their principal licensee in different geographic markets did not find that they had achieved either worse terms or better terms in the UK compared with those territories in which there was more than one licensee.

9.11 Overall, whilst the evidence we reviewed with regard to the major studios was limited in scope and subject to a number of limiting factors, it did not clearly indicate that the major studios had achieved either prices or terms in the UK (or in any other market where there was only one buyer of their FSPTW rights) which were worse than in other territories in which there was more than one licensee of FSPTW rights. We noted that this conclusion was consistent with the fact that, during the course of our investigation, the major studios generally gave us no indication that they had any concern about being unable to extract the full value for their FSPTW rights in the UK because of Sky having significant bargaining power.[6] We also noted that, since the time this analysis was undertaken (it focused on arrangements between the major studios and licensees up to 2011), [✂].

Non-major studios

9.12 Prior to our August 2011 provisional findings, we were told that non-major studios struggled to sell their movies to pay-TV providers for exhibition on linear channels in the FSPTW and that Sky was in a position to dictate the terms of this supply. It appeared to us that there were two ways in which the non-major studios might be adversely affected if Sky were exercising bargaining power: *(a)* Sky could license fewer movies from the non-major studios than it licensed from the major studios

[3] See Appendix 9.1, paragraph 8.
[4] The ten countries were the UK, France, Germany, Italy, Spain, Sweden, the USA, Canada, Japan and Australia.
[5] We compared the charge per subscriber (CPS) as a measure of price. See Appendix 9.1, paragraph 16.
[6] [✂]

(accounting for any differences in quality); and/or *(b)* Sky could negotiate less favourable terms for movies of the same quality. We considered both of these possibilities.

9.13 We compared the number of movies broadcast by Sky which were distributed by non-major studios with the number it broadcast which were distributed by major studios.[7] We also considered whether there was any evidence that Sky paid lower prices to or negotiated worse terms with non-major studios compared with major studios for movies of the same quality. Our analysis is set out in Appendix 9.1.[8]

9.14 The evidence available to us suggested that, in the period prior to 2011, Sky broadcast a [✂] number of movies distributed by the non-major studios than their share of box office revenue would imply,[9] [✂].

9.15 Since 2011, as a result of the emergence of the OTT services of LOVEFiLM and Netflix, we observed a significant increase in the competition for the FSPTW rights of many of the non-major studios. Therefore, it appeared to us that even if we were to have found that Sky had exercised bargaining power over non-major studios in the past, the extent to which it was able to do so now was more limited. Moreover, we had no reason to believe that the interest of these other parties in the FSPTW rights of non-major studios would diminish in the foreseeable future.

9.16 We also considered whether, to the extent that Sky had exercised any bargaining power over non-major studios in the past, competition between all studios might have been affected. However, it was not clear to us that it would have been. Given that studios gained revenues from many windows, not just the FSPTW, and from many geographic markets, not just the UK, it was unclear to us that any detriment suffered by some non-major studios in the FSPTW in the UK would have affected their ability to compete overall (for example, because they could invest less). Moreover, we found no reason to believe that any restriction on the ability of some non-major studios to compete would necessarily have adversely impacted upon final consumers given that competition between the major studios appeared to us to be broadly effective (see Appendix 3.1). The recent evidence [✂] of significant competition for the FSPTW rights of non-major studios [✂] reinforced this view.

Overall

9.17 For the reasons set out above, we found that Sky's position in the acquisition of FSPTW movie rights did not give rise to an AEC in the upstream rights market.

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[7] See Appendix 9.1, paragraphs 36–45.
[8] ibid, paragraphs 46–59.
[9] Movies distributed by the non-major studios represented [✂] per cent of movies shown by Sky, compared with being responsible for 20–30 per cent of revenue at the UK box office. However, we were aware that other factors might explain this difference. In particular, it might be that [✂] movies distributed by the non-major studios were responsible for generating their 20–30 per cent share of the box office relative to the number of movies distributed by the major studios.

10. Overall findings

The statutory question

10.1 Under section 134(1) of the Act, we are required to decide whether ‘any feature, or combination of features, of each relevant market prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the UK or a part of the UK’. If that is the case, under the Act, this constitutes an AEC.[1] A feature of a market can relate to the structure of the market and/or the conduct of any of the participants in the market, including customers.[2] ‘Conduct’ includes any failure to act (whether or not intentional) and any other unintentional conduct.

10.2 Ofcom referred to us two markets. The first was the supply and acquisition of subscription pay-TV movie rights in the FSPTW of the major studios, and the second was the wholesale supply and acquisition of packages which include core premium movies channels (see paragraph 1.1). We are required to consider and decide the statutory question in respect of each of the markets referred.

10.3 In this section, we draw together and summarize our findings based on all the evidence we have received, including our consideration of responses to both our August 2011 provisional findings and our May 2012 revised provisional findings. We then set out our overall findings on whether there are features of markets giving rise to an AEC.

Our findings

10.4 In Section 4 we set out our views on market definition. This analysis was undertaken to inform and provide a framework for our assessment of market features and competitive effects. In summary, we found that the frame of reference for our analysis of retail competition needed to be wider than just Sky Movies or packages including Sky Movies because consumers’ subscription decisions are affected by other elements of pay-TV packages, including at least basic pay-TV content and sports pay-TV content which are supplied by traditional pay-TV retailers. In our view, competition for subscribers was across all these elements.

10.5 We found that SVOD services, whether offered alongside linear services or on a stand-alone basis, were within the relevant market. In that regard, we found that Sky Movies on Now TV was highly relevant to our assessment of competition, and we included it in the retail market. We also found that the OTT services of LOVEFiLM and Netflix were not close substitutes for Sky Movies but that they would be regarded as substitutable by some consumers and we judged them to be closer substitutes than other pay-TV movie services previously available, such as BT’s Vision Film and PictureBox. Overall, we found there to be sufficient rivalry between these OTT pay-TV services and traditional pay-TV services to include them in the retail market.

10.6 We found that pay-TV retailers imposed a sufficiently strong constraint on each other for pay-TV retailing to be a separate market, and we focused our assessment of retail competition on this market, although taking into account the ‘out of market’ constraints from communications products and FTA TV as appropriate.

10.7 While we found no appropriate basis for defining a wholesale market consisting of either just the actual wholesale supply by Sky of Sky Movies or the total (actual and

[1] See section 134(2) of the Act.
[2] See section 131(2) of the Act.

notional) wholesale supply of Sky Movies, this did not limit the scope of our analysis of competition relevant to the wholesale supply and acquisition of packages including Sky Movies channels as set out in our terms of reference.

10.8 At the rights level, we found that the appropriate frame of reference for considering issues in relation to the supply and acquisition of FSPTW movie rights was a price-discrimination market limited to FSPTW movie rights, but including the FSPTW movie rights of all studios. However, this did not preclude us from considering a broader range of movie rights where this was necessary for our analysis of competitive effects.

10.9 In Section 5 we set out our views on retail competition. In summary, we found that Sky had market power in the pay-TV retail market and that competition in this market was ineffective. In our view, this was due to many factors, including barriers to consumer switching (particularly with respect to switching between traditional pay-TV retailers) and barriers which inhibited the large-scale entry and expansion of traditional pay-TV retailers.[3] We noted that Sky's high profitability from its UK pay-TV activities was consistent with this finding.

10.10 We concluded that while the emergence of the OTT services of LOVEFiLM and Netflix, which offered movies and previously-broadcast TV programming on demand, had increased the extent of competition in the pay-TV retail market, this was not sufficient to affect our conclusion that Sky had market power.

10.11 We found that Ofcom's concern that Sky's market power in pay TV might prevent the emergence of competition in SVOD services did not appear to have been realized as new SVOD services offering a broad range of movie (and other) content had entered the market and captured a sizeable subscriber base in a short period of time. In our view, based on the evidence available to us at the time of reaching our findings, we expected competition in relation to SVOD services to be sustained and, consequently, we expected the OTT services of LOVEFiLM and Netflix increasingly to constrain traditional pay-TV retailers over time. Nevertheless, we could not exclude the possibility that circumstances might subsequently arise such as to limit the development of OTT services in competition with Sky in the future. In this regard and in the light of our judgement that Sky has market power, we considered that the conditions of competition should be kept under close review.

10.12 Notwithstanding our finding that competition in the pay-TV retail market was not effective, the reference made to us required us to consider in particular the extent to which there were features associated with the distribution of Sky Movies and the acquisition of FSPTW rights from the major studios which adversely affected competition. A conclusion that competition was not effective in this market did not of itself lead to the conclusion that there was an AEC with respect to the matters referred to us. Nevertheless, this finding provided the context for our subsequent analysis.

10.13 In light of our finding that Sky has market power in the pay-TV retail market overall, the question as to the role of FSPTW content (and Sky Movies which has the majority of this content) in consumers' choice of traditional pay-TV retailer was a key issue for our inquiry. In Section 6 we present our views on this issue, which we summarize below (see paragraphs 10.14 to 10.19).

10.14 We noted that the number of viewings of Sky Movies had been falling over recent years and by the time of our report, Sky Movies accounted for only a little more than

[3] Pay-TV retailers who supply their services principally over a proprietary pay-TV platform as opposed to over the open Internet (ie Sky, BT, Virgin Media, TalkTalk and TUTV).

1 per cent of all TV viewing and 2 per cent of viewing hours in pay-TV homes. On the basis of survey evidence, we found that the availability of Sky Movies was significant to the pay-TV subscription decisions of only a relatively small minority of pay-TV subscribers. We also found that recent trends in the level of viewings of Sky Movies and other channels and in the proportion of Sky subscribers who subscribe to Sky Movies indicated that the significance of Sky Movies and FSPTW content in consumers' pay-TV subscription decisions had fallen over recent years. We also found that the amount of Sky's marketing budget attributable to Sky Movies was consistent with Sky Movies being of limited significance in attracting subscribers to its pay-TV platform.

10.15 We considered for this relatively small minority of pay-TV subscribers why Sky Movies might be significant to their subscription decision, and in particular the extent to which they valued Sky Movies because of its FSPTW content as opposed to its other features. Overall, the evidence suggested that many consumers within this subgroup placed more weight on other factors than on Sky Movies' FSPTW movie content (ie they valued other attributes of Sky Movies more).

10.16 Almost all of the survey evidence which led us to these views was gathered prior to the launch of the OTT services of LOVEFiLM, Netflix and Now TV in December 2011, January 2012 and July 2012 respectively. We noted that the OTT services of LOVEFiLM and Netflix offered FSPTW content from several non-major studios, as well as content from subsequent pay-TV windows and library content from both major studios and non-major studios, alongside extensive TV programming. We also noted that these services were available at a low subscription price (compared with the price of Sky Movies) and did not require a minimum contract period. Although not close substitutes for Sky Movies obtained through a traditional pay-TV retailer, we found the OTT services of LOVEFiLM and Netflix provided consumers with alternative pay-TV movie services, which at least some of those for whom Sky Movies would otherwise be significant in their traditional pay-TV subscription decision were likely to regard as substitutable for Sky Movies.

10.17 Nevertheless, we recognized that there would be some within the small minority of pay-TV consumers for whom Sky Movies was significant to their choice of traditional pay-TV retailer who would not regard the OTT services of LOVEFiLM and/or Netflix as substitutable for Sky Movies. In respect of this group of consumers, which in our view was likely to be very small relative to all pay-TV subscribers, we noted that the launch of Now TV meant that they could now obtain Sky Movies, distributed over the open Internet, without the need to subscribe to any basic paid-for content and separately from a subscription to pay-TV services on a traditional pay-TV platform (whether Sky's platform or one of its rivals). As such, these customers had the option of subscribing to Sky Movies independent of their traditional pay-TV subscription decision. Again, we recognized that not all consumers within this group would regard Sky Movies on Now TV as an effective substitute for Sky Movies on a traditional pay-TV platform (where it can be bundled with other content) but, in our view, it was likely that some would. We noted, in particular, that the content on Sky Movies on Now TV was very similar to the content within Sky Movies packages available through Sky's DTH platform or through Virgin Media, and the price was also similar (in fact marginally less than the incremental price of Sky Movies on Sky's DTH platform for customers who do not subscribe to Sky Sports).

10.18 In our view, Sky's decision to make Sky Movies available on Now TV, unbundled from other content, was consistent with the significance of Sky Movies to consumers in their choice of traditional pay-TV retailer having fallen. We also noted that, through the course of our inquiry, Sky had reduced its wholesale prices for certain of its products which incorporate Sky Movies, and had reached agreement with TalkTalk to supply Sky Movies on a wholesale basis. It appeared to us that these further developments were also consistent with this view, though we put less weight on them.

10.19 Overall, taking into account all the evidence and findings set out above, including that only a very small minority of all pay-TV subscribers were likely to regard the availability of FSPTW content as significant in choosing (or deciding whether to stay with) a traditional pay-TV retailer, and given the developments in the market which occurred through the course of our inquiry, we concluded that FSPTW content was not significant to consumers in their choice of traditional pay-TV retailer for the purposes of this part of our theory of harm.

10.20 In Section 7 we set out our views on the barriers to the acquisition of FSPTW content, in particular from the major studios. While it appeared to us that an assessment of barriers to the acquisition of movie content rights was not required in order to enable us to conclude that our theory of harm was not satisfied,[4] as part of our inquiry into the matters referred to us, we considered throughout a number of issues relating to the extent to which there are barriers to acquiring movie content in the FSPTW.

10.21 We found that traditional pay-TV rivals, or content aggregators seeking to supply traditional pay-TV rivals, had historically faced material barriers to acquiring the FSPTW rights of the major studios because Sky's position, with a substantial incumbent base of Sky Movies customers, had meant that, when bidding for rights, Sky had been more confident relative to its rivals that it would be able to monetize the rights it acquired. This had enabled Sky to bid more for the rights than its rivals. However, we found that the barriers faced by OTT pay-TV retailers in acquiring FSPTW content were lower than for traditional pay-TV retailers principally because we found that OTT pay-TV retailers, such as LOVEFiLM or Netflix, were likely to face fewer difficulties than a traditional pay-TV retailer in attracting subscribers to their movie services. This was because they could generate new consumption from the large pool of potential customers who were not currently pay-TV subscribers and also because the barriers to traditional pay-TV subscribers taking up OTT services (as an addition to or partial replacement for a traditional pay-TV package) were likely to be lower than the barriers to switching traditional pay-TV retailer. We noted that, in the future, as the customer bases of these providers increased, their ability to monetize the value of the rights they obtained would improve and they would incur less risk when bidding, eroding Sky's bidding advantage further.

10.22 We observed that both LOVEFiLM and Netflix had each acquired FSPTW content from non-major studios, [✄]. We also observed that, [✄]. While we could not be certain of the commercial incentives of any party to participate in any given auction process and ultimately to make the necessary investment to win, in our view, there was a realistic prospect that, in the future, an OTT pay-TV retailer would be able to outbid Sky for the FSPTW rights of at least one major studio.

10.23 Our findings on the significance of FSPTW content to consumers in their choice of traditional pay-TV retailer implied that it was implausible that the terms of Sky's

[4] As part of our assessment of significance, we considered the extent to which the OTT services of Netflix and LOVEFiLM were substitutes for Sky Movies and took into account the content rights which each of these OTT pay-TV retailers had acquired at the time of our report. In reaching our finding on significance, we did not rely on any expectation that either Netflix or LOVEFiLM (or any similar service that might become available in the longer term) would offer a superior content proposition (in terms of range or recency) than either did at present. On the basis of the rights already acquired, there did not appear to be any barriers that would prevent LOVEFiLM and/or Netflix (or an equivalent OTT service provider) from retaining and/or acquiring content rights which would allow them to maintain a movie offering that was a substitute for some subscribers to Sky Movies consistent with our finding on significance.

wholesale supply of Sky Movies could cause Sky's rivals to be at such a disadvantage when competing for pay-TV subscribers as to harm competition. Therefore, we did not believe it was necessary for us to examine issues in relation to wholesale supply by reference to the questions we posed under part *(d)* of our theory of harm in order to reach a conclusion overall as to whether our theory of harm was made out. Nevertheless, we acknowledged that, if there was clear evidence indicating that Sky was seeking to restrict the supply of Sky Movies, in order to constrain its rivals' ability to compete with Sky for pay-TV subscribers, this might cast some doubt on the views we had reached on the significance of FSPTW content based on other evidence.

10.24 We found, in relation to price, that it was not clear that rivals were at the time of our report at a material disadvantage when retailing Sky Movies; and, in relation to non-price terms, the relevant evidence was inconclusive as to whether rivals were, or ever had been, at a material disadvantage when retailing Sky Movies. However, importantly, we found that the evidence on Sky's conduct in terms of its wholesale supply was not such as to cast doubt on our views as to the significance of FSPTW content which we had reached on the basis of other evidence. We also noted that changes in Sky's wholesale behaviour, both in reducing its wholesale prices for certain of its products which incorporate Sky Movies and in reaching a wholesale agreement with TalkTalk, were consistent with the significance of FSPTW content to consumers in their choice of traditional pay-TV retailer having fallen.

10.25 We recognized that the recent statements and actions of parties might have been influenced by our inquiry and that there were many uncertainties in relation to the future negotiations for the wholesale supply of Sky Movies. We also recognized that if there was a material change of circumstance with respect to Sky's wholesale supply of Sky Movies, this might warrant scrutiny by Ofcom. We set out our views on this issue in Section 8.

Effects on competition in the retail market

10.26 Our finding with regard to the significance of FSPTW content (and Sky Movies which has the majority of this content) (see paragraph 10.19) led us to conclude that Sky's position with respect to the acquisition and distribution of FSPTW movie content on pay TV did not give Sky such an advantage over its rivals as to adversely affect competition in the pay-TV retail market. While not necessary in order for us to reach a view on the statutory questions, we noted that our views on the barriers to the acquisition of FSPTW movie rights were supportive of our overall finding in this case (see paragraph 10.22).

10.27 At the time of reaching our findings there was necessarily limited empirical evidence on the implications of some of the recent developments which we took into account. Overall, our findings were based largely on current market circumstances and a substantial part of our analysis was based on considerations other than those relating to the recent market developments but, where necessary, we formed expectations as to whether relevant circumstances were likely to persist. In particular, as the launch of new OTT services was relevant to our analysis, we could not ignore or attribute no weight to them simply because we had less evidence relating to them than in respect of the (now changed) circumstances before they were launched. Therefore, we exercised our judgement and formed a view as to their likely implications in the light of the evidence available. In doing so, we recognized that it was not possible to reach precise conclusions as to how developments would ultimately turn out in the future, and we exercised caution accordingly. To the extent that they were relevant to our conclusions, we sought to rely only on broader conclusions which we believed were clearly justified by the evidence available. For example, our findings did not rest on any precise prediction as to the likely subscriber numbers of LOVEFiLM and Netflix in, say, two years, but they did rest in part on a much broader expectation that at least one OTT movie service (whether LOVEFiLM or Netflix or an equivalent service) would survive in the market in competition with Sky Movies in the longer term.

10.28 We also put weight on the expectation that Sky was likely to continue to offer Sky Movies on Now TV (or an equivalent service) on an unbundled basis, enabling consumers to subscribe to Sky Movies separately from any other pay-TV content and separately from a subscription to pay-TV services via a traditional pay-TV platform (whether Sky's platform or one of its rivals). Further, given our finding on significance, we did not expect Sky to have a strategic incentive to withhold or limit the availability of Sky Movies in order to provide it with an advantage over its rivals in competing for subscribers in the pay-TV retail market (see paragraph 10.23).[5] However, in light of Sky's position in the pay-TV retail market and also recognizing the fast-moving nature of the market, we expected Ofcom to keep developments in this sector under review and we noted that, in the event that circumstances changed materially, some renewed scrutiny of the issues covered by our inquiry might be warranted.

Effects on competition in the rights market

10.29 We considered whether Sky's position as an acquirer and distributor of FSPTW movie content on pay TV might adversely affect competition between the suppliers of FSPTW movie rights (see Section 9). In our view, the evidence did not clearly indicate that the major studios had historically achieved either prices or terms in the UK which were worse compared with other territories where there was more than one licensee of their FSPTW rights. Furthermore, although there was some evidence to suggest that, [✂]. We also found no reason to believe that any restriction on the ability of some non-major studios to compete would necessarily have adversely impacted upon final consumers given that competition between the major studios appeared to us to be broadly effective. Moreover, we noted that, more recently, there had been greater competition for FSPTW rights. Therefore, we found that Sky's position as an acquirer and distributor of FSPTW movie content did not give rise to an AEC in the upstream rights market.

Answering the statutory question

10.30 We considered the statutory question in respect of each of the markets referred, which was whether 'any feature, or combination of features, of each relevant market prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the UK or a part of the UK' (see paragraph 10.1). The findings set out in this report were based on our detailed consideration of all the evidence available to us, including the representations made by all parties during the course of our inquiry.

10.31 In light of the analysis set out in this report and summarized in this section, we found that Sky's position with respect to the acquisition and distribution of FSPTW movie content on pay TV did not give Sky such an advantage over its rivals as adversely to affect competition in the pay-TV retail market. Further, we found that no AEC arose in the upstream rights market as a result of Sky's position with respect to the acquisition and distribution of FSPTW movie content.

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[5] Though clear evidence to the contrary might cast some doubt on the views we had reached on the significance of FSPTW content based on other evidence.

10.32 Accordingly, we found that there were no features relating to ‘the supply and acquisition of subscription pay-TV movie rights in the FSPTW of the major studios’ or ‘the wholesale supply and acquisition of packages including core premium movies channels’ which gave rise to an AEC in any market.